

## TRANSCRIPT

### FEDERAL OPEN MARKET COMMITTEE MEETING

May 18, 1981

#### Prefatory Note

This transcript has been produced from the original raw transcript in the FOMC Secretariat's files. The Secretariat has lightly edited the original to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

Errors undoubtedly remain. The raw transcript was not fully edited for accuracy at the time it was produced because it was intended only as an aid to the Secretariat in preparing the record of the Committee's policy actions. The edited transcript has not been reviewed by present or past members of the Committee.

Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

#### Staff Statements Appended to the Transcript

Mr. Kichline, Economist  
Mr. Pardee, Manager for Foreign Operations  
Mr. Sternlight, Manager for Domestic Operations  
Mr. Axilrod, Secretary and Staff Adviser

Meeting of the Federal Open Market Committee

May 18, 1981

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Monday, May 18, 1981 at 9:30 a.m.

PRESENT: Mr. Volcker 1/, Chairman  
Mr. Solomon, Vice Chairman  
Mr. Boehne  
Mr. Boykin  
Mr. Corrigan  
Mr. Gramley  
Mr. Partee  
Mr. Rice  
Mr. Schultz  
Mrs. Teeters  
Mr. Wallich

Messrs. Balles, Black, Ford and Winn, Alternate Members of the Federal Open Market Committee

Messrs. Guffey, Morris, and Roos, Presidents of the Federal Reserve Banks of Kansas City, Boston, and St. Louis, respectively

Mr. Axilrod, Staff Director  
Mr. Altmann, Secretary  
Mr. Bernard, Assistant Secretary  
Mrs. Steele, Deputy Assistant Secretary  
Mr. Oltman, Deputy General Counsel  
Mr. Mannion, Assistant General Counsel  
Mr. Kichline, Economist

Messrs. Burns, Danforth, Ettin, Keir, Prell, Scheld, Truman, and Zeisel, Associate Economists

Mr. Sternlight, Manager for Domestic Operations, System Open Market Account

Mr. Pardee, Manager for Foreign Operations, System Open Market Account

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1/ Left the meeting following the action to approve the minutes and returned prior to the action to ratify System open market transactions in Government securities, agency obligations, and bankers acceptances.

5/18/81

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Mr. Coyne, Assistant to the Board of Governors  
Mr. Gemmill, Associate Director, Division of International  
Finance, Board of Governors  
Mr. Lindsey, Assistant Director, Division of Research  
and Statistics, Board of Governors  
Mrs. Deck, Staff Assistant, Open Market Secretariat,  
Board of Governors

Mr. Doyle, First Vice President, Federal Reserve  
Bank of Chicago

Messrs. Balbach, J. Davis, Fousek, Koch, and Parthemos  
Senior Vice Presidents, Federal Reserve Banks  
of St. Louis, Cleveland, New York, Atlanta,  
and Richmond, respectively

Messrs. Bisignano, Cacy, Fieleke, Sandberg, and Syron,  
Vice Presidents, Federal Reserve Banks of San  
Francisco, Kansas City, Boston, New York, and  
Boston, respectively

Mr. Lang, Research Officer, Federal Reserve Bank of  
Philadelphia

Transcript of Federal Open Market Committee Meeting of  
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CHAIRMAN VOLCKER. The meeting can come to order and we can approve the minutes.

MR. SCHULTZ. So moved.

MS. TEETERS. Second.

CHAIRMAN VOLCKER. Without objection, the minutes are approved. I want to propose a change in the order [of the agenda] this morning. I'm going to have to leave at about 10:00 a.m. for about 45 minutes to an hour, unfortunately, so I want to start off with the business discussion. I've had appointments with the President on and off and he came up with one this morning and I decided I'd better grab it while I can get it. You can go back to do the reports on foreign currency and domestic operations and so forth at that point. And then I can be back for Mr. Axilrod's presentation, hopefully. So, why don't we start off with you, Mr. Kichline?

MR. KICHLINE. [Statement--see Appendix.]

CHAIRMAN VOLCKER. Well, we have a situation continuing where forecasted downturns by a lot of people haven't materialized. I guess we ought to focus on how strong we think things are at the moment in the face of historically high interest rates. Who wants to comment? Mr. Boehne.

MR. BOEHNE. I'll start briefly. I've been spending a fair amount of time out in the Third District, and I find an unusual amount of diversity in terms of what people think about the economy. It's all the way from the brink of disaster for some manufacturing firms to strong business for health care, pharmaceuticals, and services. On average I think the "go slow" is probably right, but my hunch is that the economy is probably going to be stronger than we think it is, although there is this diversity.

CHAIRMAN VOLCKER. How strong do we think it is? That's just it.

MR. BOEHNE. Stronger than we think it is. Also, I find a fair amount of support for a balanced budget out there rather than tax cuts. The supply side approach I don't think has reached the countryside yet. I might just add that there seems to be a lot of goodwill toward the Fed as an inflation fighter. But despite some intellectual appreciation for what we're doing, the high and volatile interest rates are beginning to reach the point where it hurts. And I think the gut is overpowering the intellect in this area. That's all I have.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, I wonder if I could ask Jim Kichline to indicate those areas where he thinks the first-quarter GNP will be revised upward?

MR. KICHLINE. Inventories for one. The implied estimate was very low for March and the numbers have come in significantly higher. Business fixed investment we think could be revised up at least \$5 billion, as shipments were much stronger than their assumptions. And in construction outlays, spending put in place was running higher than their assumptions. Personal consumption expenditures may be a little higher, given the upward revision in March [retail] sales, as may net exports, which is a major contributor here in terms of a low guess prior to the availability of the March data. So, it's pretty much across the board but, surprisingly, both inventories as well as fixed investment are very strong.

MR. BLACK. What kind of percentage are you thinking it will change to?

MR. KICHLINE. We think the first digit should be 8. It's a question of how much higher. We'd say 8 to 8-1/2 percent or something like that.

CHAIRMAN VOLCKER. I think that's probably right.

MR. BOYKIN. Mr. Chairman, we are hearing much of what Ed Boehne reflected. We feel that the economy is continuing fairly strong. We really don't have any specific disagreement with the Greenbook forecast, but our fear is that the figures on both the economy and inflation will probably be revised upward. As for the comments that we're receiving from our directors, bankers, and businessmen in the District, they are expressing concern over the plight of the small businessman with these continued high interest rates. They are expressing possibly some sense of frustration in that they really don't see any end in sight and they don't seem to have the feeling that we're making very much progress.

MR. MORRIS. Mr. Chairman, if one looks at the current data coming in, one can't see any sign of weakness in the economy. And with inventories as low as they are, the prospect of any major sharp decline seems fairly remote. But at the same time, I'd simply caution that there hasn't been time yet for the data to reflect the impact of what we've done in the last couple of weeks. We've had a major change in interest rates and that, I think, is going to show up in the months ahead. I'm not concerned about the economy running away from us at the present level of rates, but--

CHAIRMAN VOLCKER. It's a little troublesome because we had higher levels of rates than this in the fourth quarter and we had an 8 to 8-1/2 percent increase in the GNP immediately following.

MR. MORRIS. Yes, but most of that [strength] was early in the period.

VICE CHAIRMAN SOLOMON. Last month the bond market had over \$5 billion of [new] corporate issues. At the time not only were bond rates high but it was a very disturbed market. Except for a couple of trouble spots, there just seems to be enormous pressure for everybody to go ahead and engage in high levels of economic activity and just content themselves with Henry Wallich's point that after taxes interest rates are not that high. That seems to be everything I hear up here in the financial markets.

MR. BOEHNE. Well, I didn't hear that in Pennsylvania, New Jersey, and Delaware. They may not be that sophisticated, but they think these higher rates are hurting and hurting badly, especially the small and medium sized business firms.

MR. SCHULTZ. That's where it is hurting.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLE. It's obvious that there are very strong crosscurrents around the country. We see this in the West as well. The lumber industry, because of the housing industry, is flat on its back. On the other hand, we see the opposite extreme in office building construction, for example, which is [experiencing] real boom conditions in San Francisco, Los Angeles, etc. Agriculture, our leading source of income in the State of California--I guess it's now the biggest agricultural state in the country--is doing very well. I don't hear of any signs of collapse there despite the high cost of credit to farmers. Aerospace, electronics, and so forth are still going along very strong. In short, what continues to amaze us is the resilience of the economy despite high interest rates. I share your feelings that, looking back over the past couple of years, the often advertised coming of a recession or slowdown more often than not has not materialized. And I suspect, if anything, we're underestimating the strength of the economy. I would look for a better 1982, for reasons I won't take time to go into at the moment, than forecast by the Board's staff.

MR. PARTEE. How is housing out there, John?

MR. BALLE. It's about the same as around the country--poor.

MR. PARTEE. I know, but you don't get any feeling of uplift?

MR. BALLE. Not as yet, because all these variable rate proposals haven't really had a chance--

MR. PARTEE. Yes.

MR. BALLE. --to take effect in terms of restimulating the industry. But I think when those do get underway, that will have a beneficial effect.

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. Mr. Chairman, I continue to believe that the economy is stronger than the so-called consensus forecast, which I think would encompass Jim's forecast. In terms of the underlying demands, the suppressed demands, given that in the short run the capacity to snap back very quickly in housing and other areas is so great, I can't see much of a significant downside risk. The major imponderable in all of this is how much financial stress is really there that we don't see. We focus a lot on the thrift industry because we know a lot about it. But I suspect that there probably is a good deal more stress around on balance sheets and other things than we perhaps really perceive.

The other point I would make is that, at least in the Ninth Federal Reserve District, I have a hard time finding anybody who thinks that a three-year tax cut is a good idea. There's a certain hesitance for people to talk about that publicly. I'm not sure why. I guess so much hope is pinned on getting some spending cuts here that they don't want to compromise that. But certainly in private discussions I can't find anybody who thinks that a three-year tax cut is a good idea right now.

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. One of the interesting areas is the steel industry, which is running currently almost at capacity. How much of that is inventory building is not quite clear, but think about what would happen if automobile sales should pick up or--this is hard to determine--if defense orders start to flow to a greater extent than they have previously. We'd have a really tight bind with respect to steel. The second thing is that if you look at retail sales across the board, and they have been very strong, [our sources] all report that it is for top-of-the-line merchandise. The bargain stuff isn't moving very well. This is not a feeling of weakness in my judgment in terms of what is happening there. One has to watch this comparison with last year--which is how retailers report sales--because of the credit crunch and the difference in when Easter falls and other things. But retailers thought sales would tail off after Easter and they are continuing quite strong even through last week, which is a rather strange phenomenon. The third point I'll make is that on John's point about office building and other kinds of activities we may have a bit of a booby-trap in this area in that most of those have been financed on construction loans without take-outs in some instances. And the question is: With the change in interest rates, what kind of take-out set-up are we going to have for some of these things? They went ahead with the buildings thinking that if they couldn't find financing, they would sell them. We may have more for sale here suddenly than some people have expected. And this is a financial booby-trap out there that may or may not snap at us.

CHAIRMAN VOLCKER. Mr. Roos.

MR. ROOS. We sense a fairly strong base of economic activity in our area. There are two dramatically weak segments, home building and automobile manufacturing, and the latter is a big factor in part of our District. However, commercial building, as John said, is very strong, as are chemicals, military equipment, and oil and gas equipment. Basically, we don't see many signs of weakness except in those two specific areas I noted.

CHAIRMAN VOLCKER. Mr. Ford.

MR. FORD. In the South we have a mixed picture that reflects some of the things you've heard from other areas. The tourist business is great. As for the steel industry in our area, surprisingly, after years of disaster around Alabama, U.S. Steel is planning to put up a new plant of all things and employment is rising in that industry. In our high-tech belt that is developing around Atlanta and Florida, the high-technology industries are doing great. The defense-related industries are doing great. In housing and

construction, surprisingly, while activity is not great, on a month-over-month basis it is up and on a year-over-year basis it is up. Mortgage loan closings are up; we don't understand why, but apparently they are. The agricultural sector would be all right were it not for the fact that everybody else in the country has gotten rain except us apparently, and there is still some concern about the lingering effects of the drought we've had.

The big area of worry is in the financial sector where, on the banking side, our banks are doing not just well, they're doing fantastically well. Big banks in Atlanta and Florida are up 25, 30, 35 percent year-over-year, quarter-over-quarter, anyway you want to measure it. But there are areas of stress. I've been going out, as Ed has, trying to get closer to the individual industries and some of the particular players to hear how it sounds to them. The thrift executives are counting [reserves]; they are all down. I've now talked to about 8 or 10 of them individually because I made the mistake of making a public speech about their problems a month before everybody else did, so I've been going around trying to heal the wounds and listen to them. What I hear is that they're all measuring their survival literally in terms of how many months of reserves they have left at the current rate. They all have it counted out that way and they are in a near panic state, as [the Board] will hear when it meets with its Advisory Committee later today or whenever.

Consumer finances are starting to worry me in that we see more and more isolated signs of stress on the consumer balance sheet tipping upward. One of the biggest industries in our area is Equifax credit reportings, for example, and they say business is great. There is more concern than ever about the credit condition of the consumer. The collection companies are doing great, which is bad news in terms of financial stress. Another thing that worries me is that we're starting to get some evidence of creative financing; as a concept, I think it is very worrisome and something we're going to have to focus on. A lot of financial balloons have been put up in the air where people are disintermediating [from] the normal lending agencies and taking back paper on homes. That is done on the basis of very questionable credit standards or none at all. And I'm starting to hear more and more people, as I talk to people about housing finance, talk about possible problems in the area of creative financing.

Finally, all over the District I'm hearing from small businessmen, especially dealers of U.S. built autos and various other small businesses, that they are actually paying 1 or 2 points over the prime rate. They support us tremendously philosophically, but they wish we would lower interest rates today because their survival is in question now. I haven't been able to verify how much of that is true, but every time I go out to a meeting or sit down at a rotary club talk or wherever people get me in a corner and I ask them: "Do you believe in what the Fed is doing?" They say: "Terrific, you're on the right track; hooray for you and Ronald Reagan." Then if I ask how business is, they say it's terrible. They say, for example: "It costs me more to finance a car on the floor of my showroom for one month than I can ever hope to make in profit, and I'm not selling it within a month." So, my big worry would be the overall stresses and strains in the vulnerable areas on the financial side. Overall, I would say the economy in the South is moving sideways. We have strong areas that are booming balanced off by these areas of weakness. We don't see a

big surge coming, but we don't think we're in a depression or a recession now at all.

MR. SCHULTZ. I told you about going to a cocktail party a couple of months ago. A fellow who happened to have had a few drinks came up to me and clapped me on the back and said "I want you to know that I'm with you all the way, you S.O.B."

SPEAKER(?). That's the exact [sentiment].

MR. FORD. That very much summarizes what I'm hearing.

CHAIRMAN VOLCKER. Mr. Doyle, let's get the depressing side of this.

MR. DOYLE. Sorry to add to that, Mr. Chairman. The automobile industry is still in a very depressed state in our District and its influence is quite pervasive. Even though production has been up quite a bit lately, largely associated with the introduction of some new models, no one I talked with really expects much of a turnaround in that area at all. There now seem to be increased concerns spreading somewhat to the rural areas. The banks are highly liquid, but high interest rates are discouraging borrowers and we tend to hear more and more from this particular sector recently. The drought has ended in the Middle West and it has brought with it some rather interesting revisions in estimates of food price [increases] for this year, which are expected to be somewhat less than the USDA projections--say, somewhere around 10 or 11 percent rather than up in the 11 to 12 percent range.

CHAIRMAN VOLCKER. Did you get rid of your dry weather, Mr. Guffey?

MR. GUFFEY. It largely has abated, yes. Just over the last week to ten days we've gotten very good rains and very general rains. There is some good and some bad news to that. Along with the rains was some very severe weather; and much of the winter wheat, which would be harvested commencing in early June in the southern part of the District, was laid flat by the hail and high winds. So, the question is whether what wheat survived will result in a good crop, beyond earlier expectations; that which was flattened is a total loss. The USDA doesn't know what is out there and I don't think the farmers can tell. Not until the harvest is completed will we know. The fact of the matter is that the outlook for the agricultural sector probably is better at the moment than it has been over the past sixty days, with the exception of the red meat industry, particularly the cattle industry. There has been a continued liquidation of breeder stock, keeping meat prices down. As a result of that there is a loss in the cattle in the feedlot area. That has to end one of these days; and when it does, we will quite likely see an escalation of meat prices, which will roll into [consumer] food prices.

On the other hand, the District is heavily engaged in the energy business and that is going gangbusters. The unemployment rate ranges someplace from 3-1/2 percent to 8 percent, depending upon whether you're in Oklahoma, Colorado, or New Mexico. It's a very mixed picture.

CHAIRMAN VOLCKER. Well, I'd better run in a second. We have heard from all the presidents; the governors have all been silent. We'll leave that to you. And you can go over these other [agenda items].

MR. GUFFEY. Before you leave, Mr. Chairman, I should say that the green bug problem has been whipped with a red lady bug.

CHAIRMAN VOLCKER. Good. By what?

MR. GUFFEY. Lady bugs.

CHAIRMAN VOLCKER. Count on the lady bugs!

MR. SCHULTZ. Let me ask a question, Roger. Are the cattle being slaughtered or are they being put back in the pasture? With the rains you've had, I would imagine some are going back to pasture.

MR. GUFFEY. Well, I can't answer the question of what may happen in the future. The rains have only occurred within the last ten days, so those judgments might be made in the future. But they certainly haven't been up to now. Conditions have been very dry and as a result the cattle have been taken off of the range for two reasons. One was that the prospect for keeping them through the upcoming summer was not very good. Secondly, those in the feeding business were losing from \$75 to \$200 a head on fat cattle. So, they are just liquidating their breeder stock. Whether or not business judgments will be made to maintain some of that breeder stock now that some green grass has come forth, I don't know. It doesn't bode well, however, for food prices for the period ahead.

VICE CHAIRMAN SOLOMON. We haven't heard from any governors, I don't think. Emmett.

MR. RICE. I'll start off. Much of what I've heard from the presidents confirms the feeling I've had about our current situation. If I had to characterize the current economic situation, I would say that the economy is slowing from a very high rate of expansion but it is not by any means weak yet. I say this because it's hard to see any unqualified indications of weakness. Even in retail sales we see, adjusting for autos, an increase. And the slowing in industrial production, while negligible, would actually be an increase if it weren't for the coal strike. So, most of the indications of weakness --for example in the payroll employment area--are not unqualified. On the other hand, there are some fairly good indications of enough strength still left in the economy. Business fixed investment is still strong. And, of course, capacity utilization has increased. So, I would say on balance that there may be some slowing but it's a slowing from a very rapid rate [of expansion] and the economy is not at all weak at this point.

VICE CHAIRMAN SOLOMON. Governor Gramley.

MR. GRAMLEY. I deliberately stayed out of the talking stage and in the listening mode because it seems to me that it's more difficult than I can ever remember to know what is happening by looking at the statistics from here in Washington and by using the typical technology of forecasting, either models or judgmental

forecasts. The economy just isn't behaving the way it used to. I think the staff is basically right, however, that we're looking at an economy that is quite strong. The areas of weakness that we do see--and we are seeing some weakness in the housing industry and the auto industry, which is being reflected in the employment statistics and to some degree in industrial production--are in credit-sensitive sectors. To the extent the economy is being restrained at all, it's being restrained by monetary restraint, by very high interest rates. What the staff is saying, in effect, is that interest rates will simply rise however far they have to rise to get nominal growth of GNP down to the 8 to 9 to 10 percent range or somewhere around there. And I think the only issue is whether or not the staff's forecast of interest rates is right. The staff's forecast of interest rates, in comparison with the major outside forecasters, leaves no doubt that outside forecasters aren't anywhere close to being correct if the staff has the basics [right] on where the economy is going. The staff has interest rates on Treasury bills continuing to move up through the last three quarters of 1982, hitting a peak of around 17 percent; they are moving up gently but continue to move up. The mean of other forecasters has the peak of interest rates in the first quarter of 1981 and coming down to about 11-1/2 percent by the end of 1982. That's why I think we're seeing a major difference in what forecasters see for the outlook from now until the end of next year. The economy is very strong, and I don't think we are likely to make a mistake at this point of overrestraining it unless we take very drastic action on top of what has already been done.

VICE CHAIRMAN SOLOMON. Henry.

MR. WALLICH. Well, I find the economy very hard to read, as do others. Some things don't quite seem to fit together. For instance, we've had this strong surge in the first quarter, which may be revised up. But it doesn't seem to have led to a great increase in capacity utilization; it may have in materials but not in other areas. And it hasn't led to a reduction in unemployment, as one would figure. Now, if we are looking at this first quarter, it really means that GNP from here on out will be about 1 percentage point higher than it would have been had GNP grown at something like 3 percent or so--spreading the difference roughly over the rest of the year, or dividing it by 4. So, the whole picture is somehow tighter. And that I don't quite see reflected in the capacity utilization or the unemployment figures; but it must be there. I also am asking myself: Why, in an economy in which no single thing seems to be outstandingly strong, is there so little room? Why, when we've got some distinctly weak sectors like housing and automobiles, has the economy been expanding so rapidly? Is it because the saving rate is so low that we're now at a much higher level of consumption than we normally would be so that leaves less room in the economy for other things and is squeezing things out? I find all these things difficult to reconcile, but there seems to be no doubt that the economy is not going down even moderately as much as thought; it may not go down at all and is overall very strong.

VICE CHAIRMAN SOLOMON. Chuck.

MR. PARTEE. Well, I don't think there's much downside risk either, except if there should be some unexpected financial difficulty that would lead to it. And that's always hard, indeed impossible, to predict or to time. I would agree with Lyle that the governor on the

economy is monetary policy. And with emphasis on the aggregates, what we're really talking about is how high interest rates will go. But, of course, as they go higher, if they should go higher, the small business problem and the problem with housing and with automobiles and so forth will get greater and greater. Indeed, that's the disturbing factor about the economy. There doesn't seem to be too much effect in the soft goods sectors and certainly no effect in the defense area. There is a strength that could end up in a bad crash, I think, in nonresidential construction. I agree with Willis that there are a lot of problems that could develop there because there's an expectation that prices will go higher and that the properties will appreciate. If they don't, then there is no basis for the financing being done on them. So, the concern that I'm beginning to have is that to achieve the 9 percent nominal GNP that Lyle speaks of, we will have no activity to speak of in some sectors and hardly reduced activity in other sectors. The differential impacts are going to be very difficult to deal with. Henry made a good point a month or so ago, in a speech that I guess he didn't deliver, which is that there are two tiers in terms of interest rate effects. Those who don't pay 46 percent tax rates are hurt a lot more than those who do pay 46 percent. That's very consistent with the notion that small business is complaining, because they [don't] pay 46 percent tax rates. And it would be very consistent for any firm that is in a loss position to be badly hurt. It reminds me of the [adage] that the worst thing a bank can have is money--that the bank should get so that it doesn't have taxable income. The same thing is getting to be true of debt burden. The worst thing you could have, if you have any taxable income, is not to have a debt burden because then you don't have any tax write-off. So, I agree that we're in a fairly narrow range with very little chance of a sizable decline in the immediate picture and a good control over the expansion because monetary policy is well along the road toward being restraining. But as to the effect that this will have in the longer run, I'm certainly not prepared to say at this point.

VICE CHAIRMAN SOLOMON. But isn't it likely from what everybody is saying around the table that we're going to see monetary policy not being very effective as a general restrainer until some of the troubled areas have some dramatic failures? And then we would get a reaction in the rest of the economy.

MR. PARTEE. Yes, we could get a sharp change in expectations. The people who are expecting prices such as real estate values to rise will stop expecting them to rise. And then suddenly what didn't seem to be such a high interest rate before will seem extraordinarily high, and that could happen very quickly. But one just can't predict when it will happen. By the way, though, Tony, I do think that [our policy] is having a restraining effect on the economy. It's clear that housing starts are not going to stay at 1.2 million; they're going to drop below it. And that's very restraining. That's one of the biggest industries in the economy, and it's largely due to interest rates that housing activity is as low as it is. On inventories, I agree with Frank. He said inventories are very, very lean. Why are they lean? It's because interest rates are so high that everybody pays great attention to keeping inventories down. The automobile business, which in the last two or three 10-day periods has been below 6 million in domestic sales, is 4 million off what the industry has been accustomed to. That's a big cut in output in GNP.

So, interest rates are restraining the economy; and the higher they go, the more they will restrain.

MR. CORRIGAN. But even in terms of the residential construction that is still going on, I don't know for sure, but I would venture a guess that a substantial fraction of the housing starts we're seeing right now is being creatively financed. Every place you go you see condominiums, and the sign out front says 10-1/4 percent mortgage money.

VICE CHAIRMAN SOLOMON. It's for 2 to 3 years.

MR. CORRIGAN. No, these are term loans. The way they're being financed is that the builders go to the bank or the S&L and work a deal for a construction loan. They take out all the first mortgages on a term basis at 10 percent or something in exchange for \$300 or \$400 or \$500 thousand in fee income, which the institution takes right in, charges it as current income, and passes it right down to the bottom line.

VICE CHAIRMAN SOLOMON. But they don't give 10 or 11 percent on a fixed rate mortgage for 25 years.

MR. CORRIGAN. Absolutely, yes they do.

MR. PARTEE. It's the other way around.

VICE CHAIRMAN SOLOMON. The story that I've been hearing from people in the Midwest whom I know in the real estate insurance business is that they have this "teaser" rate. I don't know what they call it. You come in and get 10 or 11 percent financing for the first 2 to 3 years, during which time the builder compensates the thrift institution. But thereafter the loan has to be renegotiated.

MR. CORRIGAN. There are some of those, but there is an ample number of these deals that I've just described where people still can get a 20-year mortgage at 10 to 11 percent.

MR. WINN(?). They add it onto the price, Tony. They just jack the price up.

[VICE CHAIRMAN SOLOMON]. Nancy.

MS. TEETERS. Well, I'm surprised at the first quarter, and I don't really understand it. However, I am also getting very worried about the cumulative effect of this [monetary policy restraint]. If real GNP revises up even to 8 or 8-1/2 percent, there literally has been no real growth in the economy for two years. That to me says that monetary policy has been working quite well in restraining the economy from any growth. We've never had a period like this in which we had literally no growth on average for that [length of] time. I think we have to continue to restrain [the economy]. However, I am very worried that we will restrain it to the point that we will get interest rates that are going to be really damaging to all segments of the economy. Interest rates may be [low] after tax, or in real terms, but they are still contributing to cost and are creating, I think, some of the upward pressure on prices. You may be in a 46 percent tax bracket, but you still have to recoup that 18 or 20 percent interest

rate in order to pay your taxes on it. This forecast has eight quarters of 18 percent interest rates. I just don't think the economy can survive that way. Either it's going [to blow] up on us in the sense that inflation is going to take off or we're going to have major failures and we are going to get a major recession from this someplace down the line. And I urge caution when we come to deciding what we're going to make the interest rate because I think [the high rates] are damaging. They can do a lot of damage if we are not careful.

VICE CHAIRMAN SOLOMON. John Balles.

MR. BALLES. Well, I will just piggyback on Fred's S.O.B. story with one I find extremely instructive. Two

lumber companies. One is a great big one and one is a small one. And if there's any industry in the country, along with autos, that should be screaming for relief from high interest rates, it seems to me it would certainly be the lumber industry. Yet both of these guys are foursquare for solid monetary restraint, enough to get the job done in bringing inflation down. When their quiz them on how they can support this kind of restraint in terms of what its doing to their business, the explanation is along the following lines: They have two choices, both of which are bad, but one is worse than the other. One choice is to price people out of housing temporarily through high interest rates; the other, as they put it, is to price them out of housing indefinitely and permanently through ongoing double-digit inflation. So, even looking at their own long-run self interest, they favor monetary restraint and are not ready to throw me out the window or out of my job--if they could--because of what we are doing to their businesses. I find that rather instructive.

MR. PARTEE. They're not facing bankruptcy.

MR. BALLES. No, but the small lumber company is surely making no money.

MR. PARTEE. That's what I was wondering.

MR. BALLES. It will be a while, but they're not facing bankruptcy.

MR. BOEHNE. They probably have some independent wealth, though. I've run into some people like that, too, and they always have some private means if the [business] goes under.

MR. ROOS. I think it's important to recognize that there is absolutely no way of reducing these interest rates, even short-term interest rates, through the old traditional way of pumping money into the economy. We did an analysis in St. Louis. [It shows that] even when the weekly figures show an increase in the money supply, it is meaningless; within a week interest rates rise. So, I don't know how we can bring these rates down through monetary policy other than by creating a credible track record where people will really believe that we are going to bring the rate of money growth down and stick with it.

VICE CHAIRMAN SOLOMON. Either that way, Larry, or with an old fashioned crunch. My guess is that it's more likely to be an old fashioned crunch. If there aren't any additional comments, we'll move

on to Scott Pardee's and Peter Sternlight's reports. Does someone want to make a further comment?

MR. FORD. I'd just like to ask you a question on the point you just made with regard to an old fashioned crunch. I'd be interested in knowing, Tony, how serious you think this business is with the mutual savings banks up there [in your area]. I hear that one of them already has a negative net worth and that a number of others are very close to that. What do you see as the scene over the next three to six months?

VICE CHAIRMAN SOLOMON. What I hear, and what my people's analysis suggests is likely, is that between two and four of them, of which a couple are very important, are calculating that they will have a crisis early next year. They are also calculating the number of months they can take this; and, of course, if interest rates were to go significantly higher, that [crisis] might be moved up a couple of months.

MR. FORD. That would mean early winter or late fall of this year.

MR. PARTEE. I don't think the savings banks are really quite that close. It's 1982 and 1983 for the savings banks. It's 1981 and 1982 for the savings and loans.

VICE CHAIRMAN SOLOMON. But I'm talking about two to four coming in early '82.

MR. PARTEE. Yes, that's about what the FDIC feels.

VICE CHAIRMAN SOLOMON. But there are a few others that would--

MR. PARTEE. By '83, if rates stay up as our forecast has them, there are going to be quite a few. And they go beyond New York and Boston.

MR. BOEHNE. Add Philadelphia by 1982-83. We have at least one and maybe two in Philadelphia. On the timetable for the S&Ls, I think Chuck's right. Beginning in the fall of this year, stretching out into '82, you can just string them along a line, a long line.

MR. WINN. But that's with no change in the rate of flows in and out. If we have any kind of increased disintermediation, that would precipitate it in a heck of a hurry.

MR. PARTEE. Well, we would, of course, finance them.

MR. BOEHNE. How?

MR. PARTEE. At the window.

MR. WALLICH. And how about the large CDs that might run off? If this calculation is that easy to make that you can string them on a line, as Ed says, then others would be doing that, too, and would be cutting off their support.

MS. TEETERS. Has there been any indication that their deposits are being withdrawn in anticipation of failure?

MR. FORD. That's the biggest single worry I have heard from people in the thrift industry: That they have something on the order of \$50 billion in jumbo CDs that are subject to market confidence. They are being tiered on the rates right now, similar to what happened to First Pennsylvania and other banks, as general recognition of a problem approaches. I would recommend that we track that carefully on the early warning indicator. I haven't personally verified that figure, but I'm sure Chuck's staff has good information--I hope you do --on how much jumbo CD money is subject to quick market judgments.

MR. PARTEE. I don't think we have very good information because the category is \$100,000 and over. And the \$100,000 notes are pretty secure. We don't know how much is in jumbo CDs.

VICE CHAIRMAN SOLOMON. Some of the big investment banks who are financing some of the mutual savings banks with RP financing are forcing, quietly, a reduction in volume. First they tried to do it by simply raising the price on charges. They weren't getting enough response; the mutual savings banks were paying these higher and higher spreads. Now they have begun to exercise some "window guidance," you might call it, cutting back on the line. But they are trying to do it slowly so as not to trigger [a crisis]--so they wouldn't get the blame for any kind of financial problem.

MR. SCHULTZ. Most of the commercial paper that thrifts had out was in the California area, is that right? What has happened to it? Is there any indication? Does anybody know?

MR. FORD. I know that a number of them have had their ratings lowered. I don't know about the volume, which is what you asked about. I remember seeing that a number of them had their ratings lowered on paper, which should lead to the answer being that there has been a reduction in the availability, but I don't know that. I hope somebody on the staff does.

VICE CHAIRMAN SOLOMON. Maybe we'd better get moving along. There is one point I should mention. I'm told that if anybody has any questions regarding the Board's examination of the System Open Market Account, Clyde Farnsworth and Dave Robinson are prepared to answer questions. Otherwise, we won't bother with that and we'll just accept the report. Does anybody have any questions on that? If not, we'll go to Scott.

MR. PARDEE. [Statement--see Appendix.]

VICE CHAIRMAN SOLOMON. Any comments?

MR. RICE. Scott, does the Federal Reserve have any independent authority to operate in foreign exchange markets apart from the Treasury--or possibly, in parentheses, in violation of Treasury policy?

MR. PARDEE. We've reviewed this and reviewed this and reviewed this, and ultimately when it comes down to policy the primary responsibility rests with the Treasury. We can work on a consultation

basis and all of that, but if the Treasury objects, then the Federal Reserve, since I've been in it, has acceded to the Treasury's wishes.

VICE CHAIRMAN SOLOMON. The comment is simply that Congress has been fairly consistent in its attitude and that there is statutory language which says that the principal responsibility for international monetary policy is with the President, operating through the Secretary of the Treasury. There are no legal constraints on our operating with our resources but it would create a political problem, I think, if we were clearly doing it against the wishes of the Treasury.

MR. RICE. I understand the political problem.

VICE CHAIRMAN SOLOMON. There are no legal constraints.

MR. RICE. Legal constraints were what I was asking about.

MS. TEETERS. But you'd be prepared to move as you did the day Reagan was shot if there's severe disorder in the market, wouldn't you?

MR. PARDEE. I'm not prepared to move at all until I get an authorization from Washington.

MR. RICE. Do you mean from the Treasury?

MR. PARTEE. You would let disorderly conditions develop? As you see it, you just wouldn't move until Washington said yes?

VICE CHAIRMAN SOLOMON. Those are the instructions. Volcker, Sprinkel and I had a conversation. Scott was there, and [the Treasury] made it very clear that they want prior consultation before a dollar is spent. They wouldn't give us any flexibility even on, I must say, relatively minor routine countering of a disorderly market. Even though Sprinkel put in his testimony "countering disorderly markets," which is our responsibility under the amended articles of the IMF as well as internal policy, in practice I don't think the policy has changed any from one of no intervention except in an emergency. We'll just have to wait. Henry was at that meeting also and he said: "We'll see. [We'll wait] until such time as a foreign central bank requests the kind of cooperation that requires using our own resources to some degree or until the dollar itself turns around so there's a change of view." It's hard to resolve this as an abstract policy issue. I don't think there will be any change until a concrete incident or situation comes along that seems to indicate the other way.

MR. BOEHNE. What about this talk of selling off reserves and reducing swap lines? Is that serious talk in private and could that be done if the Treasury so ordered it? Or is that a joint decision to be made with the Federal Reserve?

VICE CHAIRMAN SOLOMON. My own view is that they won't insist on that.

MR. WALLICH. It seems to me that they can block, in effect, the use of the swaps for intervention, but I don't think they can compel us to eliminate them.

VICE CHAIRMAN SOLOMON. I don't think they will try. My own feeling is, even though

that this is being looked at--and it has an impact on the exchange markets--that they are unlikely to go to that extreme. The only way to get rid of the balances without upsetting markets would be to do an off-market deal with a few central banks. This would still alarm them and I think there would be political reactions. The State Department does not think along these lines at all. I think the State Department would go to the mat with the Treasury as it became more of a political issue. I don't think the Treasury is likely to go as far as actually insisting on this.

MR. SCHULTZ. Does the State Department have its economic team in place yet?

VICE CHAIRMAN SOLOMON. Yes. Myer Rashish.

MR. SCHULTZ. I know, but he hasn't been confirmed.

VICE CHAIRMAN SOLOMON. Yes he was.

MR. SCHULTZ. When?

VICE CHAIRMAN SOLOMON. Tom Andrews hasn't been confirmed, but Myer was confirmed and so was Bob Hormats. That was my understanding. It was approved by the Committee. Jesse Helms did not say anything, but continued to object. I assumed, since it was approved by the Committee about three weeks ago, that there was floor acceptance. It is normally routine that within 24 hours the whole Senate--

MR. SCHULTZ. I thought [unintelligible] told me last week that Rashish had not been confirmed. Did I misunderstand?

MR. WALLICH. I think he was confirmed after 260 questions or something like that.

MR. PARTEE. The way we would get rid of the foreign currency, I assume, is on a declining dollar market. That is, it would seem usual, wouldn't it, if the dollar were dropping to sell marks to support the dollar? And in the process we would get rid of balances and just wouldn't rebuild them. That would be a practical strategy, if we didn't want to--

VICE CHAIRMAN SOLOMON. After all, that's what the balances are there for--to cushion if we ever [wanted to]. I'm sure that the Committee and the Treasury would not want to support the dollar at these levels; if the dollar started coming down, we probably would want to do something, but not in any significant amounts. And that's quite a ways off yet.

MS. TEETERS. But what is there in the outlook that would bring the dollar down?

MR. PARTEE. Well, it's awfully high. I would think exports will fade.

MR. WALLICH. And the current account deficit. We're already predicting that.

VICE CHAIRMAN SOLOMON. Roger.

MR. GUFFEY. Further along [in his report] Scott mentioned that the French had inquired about the use of the swap line. Is the Treasury position such as to prohibit us from filling a request for the French if we otherwise chose to do so?

VICE CHAIRMAN SOLOMON. Well, it's our normal routine to touch base with the Treasury before a swap line is drawn on by a foreign central bank. On the other hand, the Chairman feels, and I think he is absolutely right, that we don't want to put ourselves in the position of not having any judgment in these matters and creating more of a situation where the Treasury is giving us day-to-day instructions. So, Volcker is planning to tell [unintelligible] that these swap lines are available. I don't think that we will run into any resistance from the Administration as a whole. Whether there will be some initial demurring by the Treasury I don't know, but I'm sure he also will advise the Secretary of the Treasury. I don't know whether Ted wants to comment in this area.

MR. TRUMAN. I think that's right. That's the way the procedures have worked in the past in the long run.

VICE CHAIRMAN SOLOMON. Where there's no large political or policy [reason] that would cause us to oppose a foreign central bank drawing on a swap line with us, I think we ought to play it in the traditional way that we've always played it. And that is that yes, it's available if the need is there; if a country explains at the time that it comes in formally [with a request to draw on the swap] and gives us good convincing reasons, obviously we will go along. That brings up the Swedish situation. Did you comment on that?

MR. PARDEE. No, I was holding that for my recommendations.

VICE CHAIRMAN SOLOMON. What does that mean?

MR. SCHULTZ. That comes next.

MR. WALLICH. When we have a swap drawing, we usually want to know where it is going to lead. With the Swedes we knew that there was a big European loan coming, which might take us out. With the French, one doesn't know where that's going to lead, and I think one has to look at the situation at the time it develops. The swaps are not exclusively for the purpose of intervention anyway. They can be for the purpose of a balance of payments financing in a broader sense. I think one can say that with regard to the Swedes, who have a fixed peg. One can't so easily say that the French have a fixed peg with the EMS, too. So, again, it becomes more a matter of financing a deficit than arbitrarily intervening in the market. I think that makes a pretty good case for the continuance of the swaps.

VICE CHAIRMAN SOLOMON. The Mitterand group is unlikely to permit a devaluation before the elections, which will probably be around the end of next month. There's an increasing feeling, of course, among knowledgeable people--and even those who are not too knowledgeable--that this level of the franc is not sustainable and that if [a devaluation] doesn't come before the election, it will come after. And there are implications that this will put a finish to the European monetary system or that even if it's preserved in its facade, it won't have very much meaning. If there are no other comments, you may turn now to your recommendations.

MR. PARDEE. I have no recommendations as far as any action by the Committee, but I want to inform the Committee that on the 23rd of May the increase from \$300 to \$500 million in the swap line of the Swedish Reichsbank that we put on last year for one year will mature. The Swedes asked if it could be extended but felt they had no compelling reasons at this point to justify the extension of that increase. They did use the line for \$200 million and repaid, as Governor Wallich just mentioned. But in recent months they have had a rather substantial inflow of funds as a result of policy measures they took early this year, so it's difficult to argue for a continuation of this increase in the current environment. It's a hypothetical situation rather than an actual situation. Discussions with Mr. Solomon and Mr. Volcker suggested that perhaps we should let the increase lapse. I informed the Swedish Reichsbank that it would lapse, as it was proposed that it would last one year. I told them, should they have further needs down the road, that the availability of the swap line is there and that if they want to discuss an increase again, we'd be happy to discuss it when they feel they have a compelling case. They accepted that, so I am just informing the Committee rather than making a recommendation that the increase be extended.

MR. PARTEE. It will drop back to \$300 million.

VICE CHAIRMAN SOLOMON. And they were not unhappy about it. They recognized that in some circles that might be interpreted as a sign of strength. When I told them it was unlikely we would [extend it], they didn't seem to mind at all. Bill.

MR. FORD. I just wanted to ask Scott if he could explain something. I'm interested in this list of a total of \$30 billion in swap lines. I'm just curious to know how you judge, for instance, that the Swiss should have a \$4 billion line, and Italy, which has more people and I think bigger [unintelligible] should have \$3 billion. How do you make a decision as to how big the swap line should be?

MR. PARDEE. Back in 1967 we had an elegant paper that was published in the Federal Reserve Bulletin on the criteria for the swap lines based on financial data, reserve position, balance of payments, size of country, and so forth. That was when we were in an active phase of adding countries to the list. We haven't added anybody since. I think the criteria are more what the problem is that we are facing at the time and what the financial interest is to the United States. Our interests are much greater--certainly they were back in 1978 when we had the last increases--with the deutschmark, the Swiss franc, and the Japanese yen. Those swap lines were increased at that

time. So, it's more in response to the situations we face. We do still review them; and the Board staff remember the criteria and bring them up from time to time when we are reviewing the size of the swap lines. In the case of the Swedes, it turned out that on these earlier criteria, if we had continued at \$500 million, then there might have been justification for some of the other Scandinavian countries to come in and ask for increases. So, we still keep the criteria in mind, but the size reflects more the pressures at the time we are dealing with them.

MR. TRUMAN. [We look at the pressures] on both sides. When the Italian swap line was raised to \$2 billion in '74, if I remember correctly, it was largely to help them out under the circumstances. In fact, as I remember, they made some drawings. And the Mexicans have also been a case where they wanted an increase to show, as the Swedes did last year, solidarity.

VICE CHAIRMAN SOLOMON. For the currencies that we think we are going to use when we're in trouble we took action to raise the swap lines as part of the November 1, 1978 dollar support package. In the others I guess we've been more or less passive.

MR. TRUMAN. The British and the Italians and the Mexicans are cases where the shoe has been on the other foot.

MR. FORD. Is this \$30 billion total here a historic high?

MR. PARDEE. Well, it would have to be the high; it will go down from the high by \$200 million.

VICE CHAIRMAN SOLOMON. It went to \$30 billion on November 1, [1978]. I gather we have to take action to ratify the transactions since the meeting on March 31.

MR. PARDEE. Collecting interest on our balances.

MR. PARTEE. Have there been any transactions?

MR. BLACK. It will be interesting to see if we get any dissents, given the nature of the decision!

VICE CHAIRMAN SOLOMON. Legally we don't need a resolution, I assume, on any transactions we do for foreign central banks. Therefore, this particular action is going to be inoperative. If there's nothing else, we'll turn to Peter.

MR. STERNLIGHT. [Statement--see Appendix.]

VICE CHAIRMAN SOLOMON. Comments?

MR. BOEHNE. I have a question. I have the impression, talking to market types and bankers on the funding side, that there is still a fair amount of confusion about what the Desk is up to. I want to inquire--it's probably just schizophrenia--in that we make money on [high] interest rates [when] we follow reserves and so on. Do you have the impression in New York that the confusion over the change in our [operating] procedures is decreasing or increasing? Do you have a sense of that?

MR. STERNLIGHT. I think a better understanding of our procedures has been developing. There was some renewed confusion or uncertainty when the February policy record was published in early April because there seemingly was a different significance to the meaning of the federal funds rate constraint. But with the record laid down there and some further comments that were made by the Chairman around that time there has been a better understanding of the significance of the funds rate limits as well, mainly as checkpoints rather than tight constraints.

MR. GUFFEY. There's confusion arising [even] within the Committee.

MR. STERNLIGHT. Well, I have no comment on that!

MR. SCHULTZ. Let me ask you a question. You recall the last telephone conversation. I expressed some concern about the market perception along these lines and wondered whether we might not be able to say things a little better in a way that might help the market. When we get to the directive today, I think some alternative ways of talking about the federal funds rate are going to surface because I do have a sense that some confusion still remains out there. On the other hand, I also have some concern that it is probably important not to change the wording very often because just a change of wording has a tendency to confuse people. So, there are pros and cons on this. Peter, do you have a sense at this point as to whether there might be some better way to explain what we are actually about in order to clear up any confusion they may have? Or is a change of wording going to add to it?

MR. STERNLIGHT. Well, as I said, I think there is a better sense of what we are about that is permeating the markets. It's a message that [could use] further repetition or elaboration as opportunities [arise] in testimony or speeches or interviews to convey just how the procedures work and our approach to the funds rate as a set of checkpoints. I've heard the question from market people: If it only has the significance of a checkpoint, why do you have it in your directives at all? I think that's certainly a legitimate point for the Committee to want to discuss.

MR. SCHULTZ. Well, that's what I keep hearing: If it's just a checkpoint, why do you put it in or why don't you just say that more clearly? They get confused about the way we say it.

MR. STERNLIGHT. I think the directive does, in effect, say that [it's a checkpoint] now.

MR. PARTEE. I think we have to have it. Otherwise, how do we know what the checkpoint is? We could say that that's what it is, although technically that's what the paragraph says.

MR. SCHULTZ. I know, but it seems to confuse them for some reason.

MR. BLACK. Peter, you say the [concept of a] checkpoint is there, but I don't read it quite that strongly.

MR. PARTEE. Why is that?

MR. SCHULTZ. Maybe I started a conversation that best ought to be done later on. I withdraw the question.

MR. STERNLIGHT. It seems to me that the change in language-- I think it was at the December meeting--[clarified it]. Up to then I think the wording called for it more as a real constraint, whereas I read the current wording as more of a checkpoint. That's because we are instructed to maintain reserves along a certain path consistent with the growth path for the aggregates that the Committee voted for and, if it appears that over a period of time the funds rate is not going to be consistent with maintaining reserves on that growth path, then the Manager is to notify the Chairman, and so on.

VICE CHAIRMAN SOLOMON. Whenever we come [to the end of our comments] in this area, there's coffee available. These transactions have to be ratified.

MR. WALLICH. I have a question.

MR. PARTEE. I have a question, too.

MR. WALLICH. Peter, knowing only what we've learned from the incoming data, had we responded very strongly to the upsurge [in the growth of the aggregates] in April would it have been possible to make much of a difference in the course of the aggregates? What would have to have been done to do that?

MR. STERNLIGHT. Well, I think we did respond promptly. We didn't get the rate effect until well along in April. Knowing how the whole month turned out, if we could have been omniscient at the beginning of the month, I suppose we could have been even more vigorous early in the month. I'm inclined to be skeptical as to whether it would have made a great difference on how the April growth rate itself would have turned out.

MR. WALLICH. But not being omniscient, just getting the numbers as they came, I presume we could have acted more immediately. We could have relied not just on the automatic mechanism that moves the funds rate; we could have dropped the nonborrowed path and raised the discount rate and so on.

MS. TEETERS. We did.

MR. STERNLIGHT. We didn't during that first four-week period, Governor Teeters; we did in the final three weeks. As I interpreted it--and Steve may want to comment--I thought perhaps there was not a need to do that in those first four weeks because there was lighter-than-expected borrowing in the very early part of April. And because of that we were going to be imposing on the banking system a demand for even greater borrowing as we got further into April, which in itself looked as though it was going to be exerting significantly increased reserve pressure without the need to make these discretionary, if you will, downward adjustments in the nonborrowed reserve path. We were looking for borrowing to have to rise up to the \$1.6 or \$1.7 billion area, well above that initial \$1150 million level, as we got further along into April.

MR. CORRIGAN. But the fact is that in the first four weeks you actually moved the nonborrowed path up.

MR. STERNLIGHT. Well, those were just technical adjustments due to the multipliers.

MR. PARTEE. I'd ask the question more historically than Henry did. We had a 13.9 percent increase in M-1B shift-adjusted in April. We had evidence fairly early on that the month would be strong because one of those early weeks came in strong. What would it have taken to have achieved, say, a 10 percent rate of M-1B growth for the month of April? Is it within the realm of possibility?

MR. STERNLIGHT. I think it would have taken [steps] that would have had to be done in March.

MR. PARTEE. Before we knew that there was an increase.

MR. STERNLIGHT. Yes. That would be my view.

MS. TEETERS. But we were well below our money growth path, weren't we, for the first three months? And to a certain extent we expected a rebound in the money supply in April in order to bring the GNP numbers and the money growth into line.

MR. AXILROD. Right. Governor Partee, worrying about how to present alternatives and so forth, we did look at the elasticities in the money market model to see if truly we could get an effect within a month, because in these alternatives we do have effects even in May from decisions taken in the last light almost--a little beyond the middle--of May. And if my memory is right--it may be off a little--it looked as if a one half percentage point increase in the funds rate [would be needed to effect the growth of money in a month]. You could [get the same effect by] working through the borrowing and nonborrowed path, but it comes down to this: that 1/2 percentage point on the funds rate seemed to [have an effect of] about 0.3 percent a month on growth in the money supply.

MR. PARTEE. Right away?

MR. AXILROD. Within the month. So, if you wanted to get [an effect of] 3 percentage points, multiply that by 10; it's probably not linear but it might be on the order of 5 percentage points [on the funds rate]. [So, if the funds rate were 13 percent at the beginning of a month] and you made it 18 percent pretty promptly during the month, according to the monthly model it would produce some genuine effect--on the order of 3 percentage points or so--in the money supply. That is all we really have to work on. But then you'd really have to know pretty early in the month what is going to happen.

CHAIRMAN VOLCKER. I don't know where you are [on the agenda]. I understand that you have to ratify the transactions. Maybe you don't want to, after all of this!

MR. PARTEE. I have one other question Paul, if I might, before we do that. We did have a large increase in rates in the month. [The increase in] short rates was historically very large and long rates [went up] quite a bit. One assumes that there must have

been losers and well as gainers in that market shift. In fact, the arithmetic suggests it, so it must be so. In that last comment in your statement, Peter, you said the big dealers are in no trouble that you can see.

MR. STERNLIGHT. Well, I said I'm not aware of disastrous losses. There were certainly losses taken, mainly in early April because they had some big [positions] at the end of March. But our impression is that losses were taken by big, well capitalized dealers. They were unhappy, clearly, but they were not put into a state where they couldn't function. There were some smaller [problem] situations, not among the major primary dealers but, as I said, among fringe operators. I can really think of just one smaller dealer operation that was put out of business.

MR. PARTEE. Yes, the one that was in the paper.

VICE CHAIRMAN SOLOMON. It's almost standard practice for all the dealers now, unlike a year ago when only half of them did it, to hedge in the futures market.

MR. PARTEE. Right.

VICE CHAIRMAN SOLOMON. Now, they [can] hedge purposely.

MR. PARTEE. Right.

VICE CHAIRMAN SOLOMON. But they can hedge pretty well under government securities.

MR. PARTEE. Well, the question I have in my mind is that the dealers hedge in the futures market and the futures market protects the dealers, then, against a very sharp rise in rates. Who is on the other side of those futures transactions and why don't we hear from them? They must have lost as much as the dealers were able not to lose.

CHAIRMAN VOLCKER. [Unintelligible] dentists.

MR. PARTEE. It may be that it's just very widely distributed.

VICE CHAIRMAN SOLOMON. There are a lot of dentists in the area.

MR. PARTEE. You haven't heard of any problems?

MR. STERNLIGHT. Well, no. The dealers did have some losses in March. In general, it's true that to some extent they were helped out by hedging in the futures market. Obviously, there were other participants on the other side of the futures market who have lost, but it just seems to be well diversified. We have not heard of terrible calamitous problems there.

MR. BALLE. I wonder if I can just ask one more technical question of Peter. Can you bring me up to date [on your procedures] when you find borrowings departing from assumptions? As I recall, the last time I heard this discussed you said that in the following period

you adjust by only half of the undershoot or overshoot, which doesn't seem to be working out all that well, as far as I can see. Is that still the practice?

MR. STERNLIGHT. Well, in the current three-week subperiod, we went beyond that kind of adjustment and moved the nonborrowed path more in relation to the overshoot. Initially we appeared to be running about \$550 million above on total reserves, and the initial downward adjustment in the nonborrowed path was \$250 million. Then a week later, it looked as if we were running over by \$375 or \$400 million and a further downward adjustment was made in the nonborrowed path because of that. There was also another adjustment; in the May 6th week we had deliberately accepted some shortfall in nonborrowed reserves because borrowing had been running higher than expected. It was kind of the aftermath of that super tight week at the end of April. So, another \$100 million or so downward adjustment was made in the nonborrowed path for that reason. In total, the downward adjustment in the nonborrowed reserve path relative to the total reserve path was \$485 million, which in this case was somewhat more than the amount by which total reserves were running above their path.

CHAIRMAN VOLCKER. We still have to ratify the transactions.

MR. PARTEE. So move.

CHAIRMAN VOLCKER. Without objection, they will be ratified. When I came back, I thought you had finished your coffee break. I see the coffee is there. Do you want to hear from Mr. Axilrod so you can chew over a doughnut and his comments? Maybe we'll do that, if you don't take too long.

MR. AXILROD. [Statement--see Appendix.]

CHAIRMAN VOLCKER. Is that all there is?

MR. SCHULTZ. Yes, he brought us right to the brink and then dropped us, didn't he?

CHAIRMAN VOLCKER. I wasn't quite prepared for you to stop so soon, but why don't we have the coffee break.

[Coffee break]

CHAIRMAN VOLCKER. We have several alternatives laid out before us. They take as their low point where we were last time as converted [for] the remaining part of the period, due to the unexpectedly high [M-1B] growth rate in April. We are, as you know, at the midpoint of the range for M-1B adjusted. The only comfort I feel about M-1B adjusted is that we estimate these shifts about three different ways and they all [produce] more or less the same [results]. They are probably all wrong, but the different ways of estimating come out more or less the same. In the last meeting we picked what is the equivalent of "C" this time, which I believe [involves growth that] is low in the range. However, if I recall correctly, the actual M2 came in a little less than we projected the last time, right?

MR. AXILROD. In April it didn't on average, but the data in late April and thus far in early May suggest that in May M2 will come in quite low.

CHAIRMAN VOLCKER. And as you see, bank credit has sneaked just inside the range and M3 remains above its range. While there is a lot of week-to-week change, I suppose that is the trend on the absolutely most recent money supply figures, if there is such a thing as a trend for about 3 weeks or 4 weeks [of data]. That's where we stand. Alternative A would leave us theoretically running in the middle of the range for M-1B adjusted but would leave us above, although closer to, the ranges in the case of the broader aggregates--only slightly closer, I guess, in the case of M2. That seems to me to be the range for our discussion. Who would like to start?

MR. PARTEE. Any of those outcomes is acceptable in terms of what might happen.

CHAIRMAN VOLCKER. I think it's fair to say the range of outcomes is likely to be somewhat wider than the ranges presented to the Committee. So, as usual, we are moving in a direction of bias and risk averseness or whatever. I agree that any of these results would not be disturbing in and of themselves. But it's a question of which way we should lean.

MS. TEETERS. Steve, you show M2 for May at 6.6 percent. Is it below that now?

MR. AXILROD. We don't have weekly data, except for certain components. But the weakness in the weekly data on money market funds and what we have seen in small time and savings deposits have led us to project M2 for May generally around that rate. So, it reflects the latest data for those components for which we have weekly data.

MS. TEETERS. The 6.6 percent does?

MR. AXILROD. Yes.

CHAIRMAN VOLCKER. Governor Schultz.

MR. SCHULTZ. Let me start out with a very quick story about the fellow who went to Dublin and asked directions to a castle outside of town. He said: "Can you tell me how to get there?" And the fellow he asked said: "Of course I can, but you can't start from here." I'm afraid I have that same kind of feeling as we go around. The last time I expressed a lot of vague fears, which I guess have all come true, that we have gotten higher interest rates and a stronger economy and everything seems to be going in different directions due to that. Money seems to affect interest rates, and interest rates affect money; but neither one seems to have much effect on the economy. So, I have some real questions about how we should go about doing this. In addition, I have the same thoughts that were expressed here a little earlier: That we are putting a lot of pressure on various parts of the economy and that it's going to be hard to get out of this without some kind of financial crisis. The one really strong feeling I have is that monetary policy alone won't do the job for us. But we don't have much choice. Over the weekend I looked at the Bluebook and I thought about "B" tending toward "A." But the more I

listen to the reports that things are pretty strong out there, it seems fairly clear that we don't have any option but to continue to restrain this economy. What we've done so far isn't having too much effect. So, I guess I would now come out somewhere between "B" and "C," keeping borrowing around \$2 billion and perhaps shading that up if necessary.

CHAIRMAN VOLCKER. Mr. Solomon.

VICE CHAIRMAN SOLOMON. Well, unless the President told you this morning that he's willing to change his fiscal policy and have a balanced budget in fiscal 1982 by forgetting about tax cuts and cutting back on defense increases--

CHAIRMAN VOLCKER. The question answers itself.

VICE CHAIRMAN SOLOMON. Unless you could tell us that, I feel that we have to go even further this way. I feel we should take alternative C, but not the initial borrowing assumption of \$3 billion. I'd start off with a \$2-1/4 to \$2-1/2 billion borrowing assumption. I think that we have to have a fed funds range going up to 22 percent. And even that will be skewed; in other words, we are likely to be near the ceiling fairly quickly unless we are very lucky and we see much lower growth in May. I recognize, if we do get something on the order of 5-1/2 or 6 percent [M-1B] growth in May, what this would require in June and that, therefore, pressure is likely to continue mounting over that period until the end of June. It seems to me that we are better off to be very firm and vigorous in our responses early in the game. I'm influenced not only by the strength of the economy--and there is a widespread feeling around the country, and certainly in the market, that with the exception of the troubled sectors the economy is very strong--but I'm also influenced by the fact that if the President's program goes through, even with a compromise on the tax cut package, the fourth quarter is likely to be much stronger, and the third quarter probably somewhat stronger, than the present quarter. And in those circumstances we might have major problems [achieving] our fourth-quarter targets. I feel we are better off trying to nip this now than trying to be more gentle in our approach; the latter approach is going to store up a lot of problems toward the end of the year. That's all I'll say right now.

CHAIRMAN VOLCKER. If I may just interrupt, I have a feeling that this relative buoyancy in the economy against expectations is importantly affected by the psychology of the Administration's program itself, the tax reduction.

MR. SCHULTZ. And the way they talk about it.

MR. PARTEE. It's the [tack] of the Administration.

VICE CHAIRMAN SOLOMON. In the financial markets, privately people will say that they don't see the difference between a Keynesian tax cut and a supply sider tax cut; it's going to be the same. We are calculating internally within the New York Fed that the budget deficit this year will be above \$65 billion and that for fiscal '82, if the President's program is enacted, it will not be \$45 billion or less but it will be \$75 billion. I would say the majority of the big firms in the financial markets also are forecasting budgetary deficits very

much higher than the Administration or even than the CBO estimates. So, that's a factor. I think there would be a remarkable turnaround in psychology and attitudes if we had a more traditional conservative approach to the deficit question by the Administration.

MR. SCHULTZ. I think the way they say it is of critical importance. The President is essentially an upbeat kind of fellow; I think he wants to talk that way. But the talk has been essentially that we can get out of this almost without any real pain and without any real problems. I just don't think that that's the right way to be talking at this stage of the game because, heaven knows, it's pretty hard to see how that could be possible. If they would talk in a little more practical way, I think it would help.

MR. WALLICH. I think they believe this. I have heard this now for a week from Beryl Sprinkel: Everything will be easy, if the Fed just keeps the money supply--

MR. BOEHNE. Yes, I was going to add to that. They say we can get out of this with no problems unless the Fed screws up. If we have problems, it's the Fed's fault.

MR. WALLICH. That's exactly it.

MR. ROOS. I don't know. In all fairness, an awful lot of us who have been advocating monetary restraint over the years have said repeatedly that we can't get over a binge such as the one we have been on without suffering pain. Whether it's Beryl Sprinkel or Joe Jones or whoever, those who have advocated restraint have also warned that there is no easy way out of it. So, I'm not sure that there hasn't been some recognition of the pain that inevitably will be required to bring an economy out of the excesses that this economy has been experiencing.

CHAIRMAN VOLCKER. I didn't mean to get off on a discussion of pain. Governor Partee, what do you have to say?

MR. PARTEE. Well, I agree that we have to be restrictive. But I would say in response to Tony that what we should do is to set our money growth course the way we would like to have it. If it deviates from that, then we'll automatically become more restrictive in terms of interest rates if we need to be tighter, or less restrictive if we need to be easier. So, I don't really see moving all the way down to alternative C in terms of the specifications. What would we like to have develop in terms of the aggregates? That's really the question we are being asked. And in my view "A" holds us right along the mid-section of the M-1B range. It's a little ample on M2 and M3 and, therefore, there might be a case for alternative B in order to adjust for having been over on the broader aggregates. As for the numbers for the aggregates, expansion of 3 percent in M-1B for April to June is quite reasonable; it's a very modest expansion and would be a quite acceptable outcome. Now, we don't know what interest rates might be associated with the 3 percent increase. And if I understand the meaning of the funds rate range now as the points at which we're to have a consultation rather than points within which the Manager operates, I think we might want to raise that range in "B" to 16 to 22 percent. I can certainly imagine the rate going to 22 percent with no trouble at all, and I don't know that it would be

fruitful to have an exchange [of views] until it gets to about 22 percent. But that's just a test point, or guidepost, or whatever you said earlier, Peter, rather than a specification to the Manager.

There is one other point that I want to make now. I think we will be in as much difficulty politically if there is weakness in the aggregates as if there is strength. We could quickly get quite a reaction from very weak growth in the monetary aggregates, and that is not unprecedented. Starting in the spring of both '75 and '76, there was a surge in the aggregates that was subsequently reversed. The fact that the last couple of occasions haven't [produced that result] doesn't mean it won't occur again. April is still an odd month; it has a lot of tax transactions in it. So it seems to me that we ought to be in a posture where we can give a little if the numbers come in weak as well as tighten up a little if the numbers come in strong, and we ought to do it from a neutral position. So, I could accept the specifications of alternative A, but I lean rather strongly to "B" as a conservative posture.

VICE CHAIRMAN SOLOMON. And would you take the associated borrowing assumption of "B" of \$2-1/2 billion?

MR. PARTEE. Well, \$2-1/2 billion seems a little strong. I wanted to ask Steve why he [raised] that. I would say \$2 billion is about where we are now, isn't it?

MR. AXILROD. That's right. We thought with our projections that to stay with unchanged money market conditions we'd expect an outcome more like "A" than "B." So, with added restraint from "B," it looked as if we'd have to have a higher funds rate, on the order of a percentage point or so higher. It is hard to relate that exactly to the level of borrowing, but that tends to push up the level of borrowing by \$450 to \$500 million.

CHAIRMAN VOLCKER. We are below \$2 billion of borrowing right at the moment.

MR. AXILROD. It was \$1.8175 billion on Friday exactly.

VICE CHAIRMAN SOLOMON. But the average of the last three weeks was about \$2 billion.

MR. PARTEE. I would say \$2 billion, Tony, and then if M-1B comes in strong, that would soon develop additional tension and additional borrowings, as it did in this last episode. I'd favor more of a neutral start.

MS. TEETERS. That implies a negative rate of growth in M-1B during June.

CHAIRMAN VOLCKER. Well, it depends upon what happens late in May. The staff is assuming an increase late in May.

MR. AXILROD. It might be helpful to add, Mr. Chairman, that the May estimate of a little over 6 percent in M-1B growth does assume an increase from the preliminary data of the 13th to the end of the month of around \$5 billion. If an increase of that magnitude doesn't

develop, May could turn out to be unchanged or be at a level that has changed around 1 or 2 percent. It could go almost either way.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, I feel this May-June period is very crucial in our efforts to convince the market that we are bound and determined to hit these targets that we've set. And given the large bulge we had in the April numbers, I feel we simply can't tolerate any more than a modest expansion in M-1B. Along with the fiscal stance that the market perceives, the behavior of the aggregates is going to be the most important thing determining the business outlook rather than all those things we hammered through in our go-around earlier this morning. So, I think we really ought to try very strongly to hit these March-June targets that we established at our March meeting, which would incline me to favor alternative C.

CHAIRMAN VOLCKER. Mr. Rice.

MR. RICE. Mr. Chairman, this kind of economic environment is one where most people see strength in the economy and where I would characterize the economy as indicating a pronounced lack of weakness. It seems to me that we may continue to see money growth coming in pretty strong. And in this environment, it seems to me the really basic question is how rapidly we want to bring M2 and M3 back to within their target ranges--whether we want to bring them back by the end of June or whether we are prepared to wait somewhat longer. My own view is that we should try to get M2 and M3 back within their target ranges as soon as possible--that is, by the end of June. And alternative C, of course, is the alternative that will do that. Alternative C, if we get the results projected, would result in all three of the aggregates being within their target ranges: M-1B at the low end, and M2 and M3 at the top. I think that is important to achieve. If we had an economy that we could be fairly sure was weakening and if money demand was slackening, we could take a longer time to try to bring these aggregates back to within their target ranges. But in the current circumstances, with recent money growth having been so strong and with every possibility that strong money demand will continue, I would see less risk in trying to get the aggregates back [on track]. Of course, to pursue alternative C would imply, as has been pointed out, substantially higher rates than we have now and somewhat higher rates than we would anticipate if we pursued alternative B. That is, we would have these higher rates in the short run, or at least during the month of June and possibly longer. However, by the fourth quarter, if I read Appendix II [of the Bluebook] correctly, alternative C would yield lower short-term interest rates and alternative B, if pursued, would yield higher interest rates. So it's a question of whether one wants to take higher interest rates now or in the fourth quarter. I would opt for taking them now. And that would lead me to favor alternative C. A final reason for favoring alternative C right now is that we really are not too sure what we are working with when we rely exclusively on M-1B. In these circumstances I think we ought to attach more importance to M2 and to getting M2 back within the target range, so I favor alternative C.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Mr. Chairman, I line up with Governor Partee on this one. I think we ought to follow a middle course here. We have had a major change in policy, as defined by interest rates, in the past four weeks. We have seen the federal funds rate move up by 300 basis points. There hasn't been enough time for us to see what impact that is going to have on the economy and monetary growth rates. I think there's a tendency as we get near the peak of activity always to feel that we are not accomplishing anything--that the economy somehow is not sensitive to interest rates. I think back to March, 1980 when that feeling was clearly dominant in this Committee. We didn't know at the time that the economy had already been climbing for two months as we were sitting at the table and as Fred Schultz was about to lead us into a vigorous credit control program.

MR. SCHULTZ. What a friend!

CHAIRMAN VOLCKER. In defense of Fred Schultz, that's not wholly apparent to me, [even] with the benefit of hindsight. Had we not had the credit control program we might not have had the decline.

MR. MORRIS. Well, I think the evidence is that the decline had already started.

CHAIRMAN VOLCKER. Ex-post people say that. I don't know.

MR. MORRIS. It seems to me that one could make a case here, at least for the next few weeks, not to set too restrictive a course in the aggregates until we can assess the effect of what we have already done. So, "B" looks pretty good to me.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLE. There are a couple of things, Mr. Chairman, that have led me in the same direction as Mr. Solomon and Governor Rice. We're beginning to wonder--and it's obviously speculation rather than proof yet--whether we aren't witnessing some downward shift in the demand for money, along the same lines as occurred in the 1975-76 episode, because of the institutional changes affecting business deposits with this surge in money market mutual funds. Some simulations we have been doing over the past five months show that M-1B is now well below the level that would have been indicated by historical demand relationships, and I'm really beginning to wonder whether there hasn't been a downward shift. I don't know what studies you have been doing on this, Steve. But if that is going on, and I suspect it might be, the shift-adjusted range that we have set for ourselves could actually give us more expansion than we counted on when we picked out the range at the beginning of the year, even though we are now, as of April, in the middle of that shift-adjusted range. And that leads me to lean more toward "C" than "B."

One thing that gives me real pause about coming out there is what Governor Gramley as well as Steve and the staff remarked on earlier today: Namely, it seems to indicate that we'd have to keep interest rates at a very high level for a very long time. We need some real weakening in the economy in order to hit even the midpoint of our shift-adjusted M-1B range. But, again, our staff has been doing some work on the differences between the liquidity preference model of interest rates and the more traditional loanable funds theory

of interest rate determination. And the net of that is that, except for the very short run, interest rates are going to be determined more by credit market conditions than pure money demand equations [would suggest]. This leads us to conclude that it's distinctly possible that we can get a slowdown in money growth this year from last year, along the lines of the midpoint of our shift-adjusted range, without keeping interest rates that high that long, and to a point where we would see somewhat more real economic growth in '81 than the Board staff [has projected] and almost about the same real economic growth, close to 3 percent, in 1982. Admittedly, a lot of this is conjectural and one might even say speculative; but taking both of those reasons together tilts me toward alternative C.

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. Mr. Chairman, when you were out, Governor Gramley spoke of some frustration in terms of trying to figure out what the economy is doing. We have more than our share of frustrations in policy here, too. We just got through revising up the money supply a little in the first quarter, convincing ourselves that that made more sense. But now we find that the GNP may be revised up more, so we're further away than we thought we were.

CHAIRMAN VOLCKER. Wait 'til next year's revision!

MR. SCHULTZ. Yes.

MR. CORRIGAN. We have a little frustration, too, with respect to this question of how quickly the banking system responds to what we do. We saw a classic illustration of that in this period here, apropos to your comment earlier, Governor Partee. We seem to have a situation where, even when we begin to firm up, what happens for a couple of weeks is that the banks sit there and wait until Wednesday and cover their whole position on Wednesday. And the funds rate doesn't change except on Wednesday and then everybody discounts the change. And then for a week or two after the banks run down their excess reserves and end up with deficiencies. Somehow or other, in ways that are not clear to me, it takes a couple more weeks and we revise away all those deficiencies with "as-of" adjustments. Then finally, after all of those processes have run their course, we begin to see some pressure either in terms of borrowing or the funds rate, or both. I will also confess to a little continuing sense of frustration about the construction of and subsequent adjustments to the reserve paths, which comes up again in this forthcoming period. The Bluebook indicates that, looking out over the April-June period, any of the alternatives contemplates a substantial acceleration in reserve growth while at the same time about the same or less growth in money. I don't know what all that means except that maybe we don't know as much as we think we know.

As I suggested earlier, there are some risks here, and I think we have to be prepared to take some risks. In the current circumstances I come out somewhere around "C," too, partly because I think the economy, if anything, is stronger, and partly because I think money growth is likely to be stronger in the short run than we expect. And finally, like Governor Rice, if we have to take a bit of a slowdown or a decline in the economy, which we may have to do, I'd rather do it now than later, partly because I think it makes more

sense in the context of hitting the annual targets but partly because it forestalls an even more serious problem that would occur if we let [money growth] continue to build up. Given all of that, I come out somewhere around "C."

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. Well, I see the economy lifted to a higher level of [activity] and, with a given rate of money growth, we have a higher level of velocity than one would have expected. Certainly, we have to [get money growth to] come back [toward our] midpoints. If we don't do that, I think we will have continuing pressure from high interest rates for a long time, with the economy being held down by always bumping [up against] the admittedly very tight-fitting money supply ceilings. I find that uncomfortable to contemplate for the future. So, if we could create a little breathing space in the real sector, letting out some of that steam that built up during the first quarter, I think we would operate more comfortably with our existing targets and in the long run we'd probably have less high interest rates. Conceivably, maintenance of these high interest rates would give us this [result] anyway through some sort of financial crunch. But we don't want to provoke that. So, I would lean toward exerting a good deal of pressure now in order to get [rid of the imbalances in] the economy and [in] the relationship of the aggregates to the economy. That suggests that "C" is the appropriate alternative. To the extent that one can [anticipate] these things, if "C" will allow the funds rate to come down later even though it may mean a higher funds rate immediately, that's what I think we should aim at, i.e. somewhat less pressure in the economy for the longer run.

I would say one other thing. Given the way we were surprised by events in April, we ought to examine whether we couldn't respond more flexibly to such developments. I realize that means responding to the weekly data in a way that the data themselves don't really justify. Nevertheless, it has happened again and again that we were overtaken by events and, in the light of hindsight, probably would have wanted to move faster. I don't recall so many instances in which we did move fast and then regretted it or didn't move and then found that that would have been the right thing to do. On balance, I think our failures have been on the side of actions [that were] too little and too late.

MR. SCHULTZ. But you want to be asymmetrical about that, don't you?

MR. WALLICH. On the down side I do have my reservations, yes. In short, I would lean toward "C."

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. I'm primarily motivated by a desire to hit the targets that we set earlier, not because they're magic but because that would tend to avoid the same kind of thing that happened in June, July, and August of last year. That is, things got away from us after one month [of] fairly large [monetary growth]. We say that isn't terribly bad, but when we start piling one month after the other, we then have a very small chance of hitting our targets for the year. Therefore, restraint at the moment

is attractive to me, but I'm not sure that I would go as far as "C." The staff's estimate of growth in M-1B of 6 percent or a little above in May under alternative B probably is subject to being off by at least 100 percent. That is, I think we could get 3 percent or 9 percent in May as easily as 6 percent. Thus, my prescription would be something between "B" and "C," with a borrowing level initially of about \$2.1 or \$2.2 billion and with the rather specific instruction to the Desk and to the staff that if money growth as it develops in May is running above 6 percent, the borrowing level should be adjusted upward promptly to \$2-1/2 billion, [the level] I believe the staff would say at the moment is consistent with "B." So, I am choosing numbers for growth in the aggregates between "B" and "C," with an initial borrowing level of \$2.1 or \$2.2 billion but I would be prepared to move borrowing up rather rapidly if growth in M-1B starts coming in above 6 percent in May. A federal funds range of 17 to 22 percent would be acceptable.

CHAIRMAN VOLCKER. Mr. Boehne.

MR. BOEHNE. I think the current economic situation and the general climate that we're in call for restraint. And we really have to hit our targets. I'd be prepared to err some on the side of restraint, but it seems to me that alternative B does that. I find going all the way to "C" to be too much in that direction. So, I would come out in the neighborhood of "B."

CHAIRMAN VOLCKER. Mr. Roos.

MR. ROOS. I would opt for "C" for most of the reasons already stated. There is one further reason, and that is the possibility that the new seasonal adjustments are a bit unrealistic in terms of the degree to which they've adjusted the aggregates downward. I'd like to throw in one other thought, too. If we are interested in achieving the greatest degree of confidence that could reasonably be expected in the financial markets, I wonder if in the directive--and this piggybacks somewhat on some of the things that Fred Schultz has said--we ought to consider eliminating any reference to our federal funds rate checkpoints. It seems to me that there could be a lot of reasons why the Chairman would consult at a critical phase. It is conceivable that growth of the aggregates, for example, could be a source of concern that might lead to adjustments. I do know that there is still a degree of uncertainty in the minds of market participants as to why we include a reference to checkpoints on the fed funds rate and not on some of the other [factors] that could influence our [need to] consult. So, I think some consideration should be given to clarifying that with a statement, perhaps by the Chairman, that we consult for a lot of reasons and that under our new procedures fed funds checkpoints are no more meaningful than other checkpoints that would lead to consultation.

CHAIRMAN VOLCKER. We'll get to that subject a little later. Mr. Gramley.

MR. GRAMLEY. Well, Mr. Chairman, I think the mood of the Committee is becoming very clear. This is a Committee that follows a tough policy. It's only a question of how far we go. I share the general view that I believe prevails here that we're dealing with a very strong economy and that our problem this year in terms of the

monetary aggregates is primarily making sure that we don't overrun the upper ends [of our ranges] rather than the other way around. But I want to call the Committee's attention to the fact that we have essentially one alternative that implies no change in money market conditions and that's "A." The other two are both tougher. And if my sense of relationships is correct, the borrowing numbers we're associating with "B" and "C" are not by any means associated with the midpoints of the federal funds ranges that we're talking about here. The present level of borrowing is less than \$2 billion. Under "C" that would go all the way up to \$3 billion. And if we go that far, I think we're going to end up having a telephone consultation by next Monday, if not earlier. We have done a lot of tightening recently, and I think we ought to try to keep that degree of tightness and perhaps go somewhat further. But I wouldn't want us to get into a situation in which if some temporary weakness in the aggregates does develop, as Governor Partee suggests it might, we would end up running interest rates back down again. That would be quite unproductive, if the Committee's diagnosis of the economic problem is a correct one. So, I think the better alternative would be to stick with "B" and then come back a month from now at the next meeting and go further if we need to.

CHAIRMAN VOLCKER. Mr. Ford.

MR. FORD. I come out pretty much on the consensus of between "B" and "C," leaning toward "C." I share the concern about the great risk to credibility and the overriding need to meet the targets and to start now rather than to wait until later. We've been fortunate that the seasonal adjustments, if I read the staff work right, had the effect of making the more recent aggregate numbers look lower. They are below some of the others, which were adjusted upward, is the way I read that.

CHAIRMAN VOLCKER. It makes April lower, but May and June higher.

MR. FORD. Yes.

CHAIRMAN VOLCKER. February is higher and April and January are [lower].

MR. FORD. Depending on how different Fed watchers interpret that, there may be a little vulnerability about some of the downward movement from pretty high numbers to quite low ones, even though in other timeframes they are offset. Overall, I would say we'd have to go with a reasonably tight policy so as not to pay later, hoping it is true, as I think Governor Rice said, that we'll get slightly higher rates now and receive as our reward lower rates later in the year than we would otherwise have under "B" or "A." However, I'm very concerned about the fragility of the marketplace. Fred Schultz in his comments mentioned the words "financial crisis" and it almost sounded casual to me, Fred. I don't mean to insult you but I don't think that's something that we should--

MR. SCHULTZ. This is not my day!

MR. PARTEE. Casual?

MR. FORD. You said there might be a financial crisis and I thought everyone would blanch. I blanched, but nobody else did. We're obviously not going to put that in the policy record, but I really do hope that we redouble our efforts to watch very carefully for possible problems arising in the most vulnerable sectors, the housing-related sectors, and try every device we can think of to help the thrifts that is not a bail-out, which would [subvert] monetary policy. I'm referring to advocating right now federal preemption of the limits on due-on-sale clauses in 17 states, including some of the biggest ones, and things like that. That would help them to reliquify themselves better without an outright bail-out, which would simply exacerbate our monetary control problems. That's the only thing I would like to add to this process as we head toward this obvious consensus of "B" to "C"--that we have to redouble our efforts in the area of monitoring and doing whatever we can that is not inflationary to help the [institutions that] bear the brunt of it. I don't know that there's an answer, Chuck. I know what you're going to say, but we had better be searching.

MR. PARTEE. Due-on-sale doesn't help them this month or next month, that's for sure.

MR. FORD. No, but if you do the calculations on the amount of money they can recycle, that makes a big difference.

MR. PARTEE. It might next year or the year after.

CHAIRMAN VOLCKER. Governor Teeters.

MS. TEETERS. Well, I'm shocked by the consensus that is emerging. I don't think this economic outlook, which is based on "A," is at all encouraging. It means another year or maybe two years of no growth in the economy. I find the unemployment rates projected, with no growth, rather unbelievable also. More importantly, it seems to me that the level of borrowing is now becoming very crucial here. At just under \$2 billion we have already put a great deal of pressure on the market. We have shot [short-term interest] rates up 3 to 5 full percentage points, depending on which ones you look at. If we move borrowing up another \$1 billion, the [proposed fed funds upper end of] 22 percent isn't going to hold. It seems to me that we really should be somewhere between "A" and "B" and perhaps move the borrowing from the present \$1.7 or \$1.8 billion to just over \$2 billion and let that be the deciding point here. I'd set the [top of the funds rate] range at certainly no more than 21 percent, which I find difficult to accept. We're putting a lot of pressure on the market now. We haven't had enough time, as Frank said, to assess what that sudden change in interest rates is going to do. I think it's foolish to run rates up another 5 percentage points in such a short period of time, which I'm convinced "C" would do at this point. I can live with "B," but I don't like it. I'd much rather have the borrowing halfway between \$2 and \$2-1/2 billion.

CHAIRMAN VOLCKER. That doesn't sound like such a weak approach.

MR. PARTEE. No, no.

MR. SCHULTZ. That borrowing [level] is pretty good.

MR. PARTEE. That's a \$400 million adjustment right off.

CHAIRMAN VOLCKER. You're above--

MS. TEETERS. Yes, but it's better than the [\$2-1/2] billion that everybody else is talking about.

MR. SCHULTZ. [I don't think] that's right. I was starting at \$2 billion and moving it up from there.

MR. PARTEE. Yes, me too.

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. Mr. Chairman, I come down pretty clearly for "C." The arguments for that position have been stated and I will not take the time to restate them. But just by way of summary: The strength of the economy worries me; I wonder about the recent rapid growth in money and that it may not be temporary; also the expectations issue looms rather large in my thinking. I think it's important to have a continuously firm policy.

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. Mr. Chairman, there are several things we haven't really talked about this morning, including the international situation, the Middle East, and a number of other things that certainly could alter the outlook very quickly. A second point is that I'd be very happy if somehow we could get away from the check writing privileges on these money funds, because I think we are exposed there with the funds investing in issues that could go sour on them. We may have more volatility built into this than we are thinking about. The third is that we talk about targets as if they were fixed and we forget base-drift and a whole lot of history that goes into them. I'm not sure that hitting the midpoint of our new range is what we really ought to be doing. A little miss on the low side might be more helpful than misses on the high side. I'm disturbed by the M2 and M3 figures, which tend to go on the high side in this set-up. On the other hand, I have some sympathy with Lyle's point of view in that I'd hate to see us run the rates up and then run them right back down again. That would not be very helpful in terms of our longer-run objectives. To take a stance at this time, I would be content to be able to hit somewhere between "B" and "C" rather than to set a target and then be all over the lot in terms of our performance. I, too, would be inclined to raise the borrowing objective to help move in that direction; I'd go to \$2.1 billion or something in that neighborhood as a first move.

CHAIRMAN VOLCKER. Mr. Doyle.

MR. DOYLE. Mr. Chairman, it's very difficult for me not to be influenced by the state of the economy in the Seventh Federal Reserve District, particularly the credit-sensitive industries, which are extremely depressed. Every day the feeling seems to be growing that the risks are greater that some of these industries may not recover their former strength. Hence, I would favor alternative A but I could reluctantly support alternative B.

CHAIRMAN VOLCKER. I guess that is everybody, unless somebody has not been heard from.

MR. PARTEE. We haven't heard from you.

MR. SCHULTZ. We're about to!

MR. PARTEE. Yes.

CHAIRMAN VOLCKER. I'll reveal my forecast on where the Committee would come out, which by coincidence or otherwise doesn't make me feel uncomfortable. We have had a 5-1/2 percent [M-1B] target for the quarter, and the alternative that's consistent with that is "C." But we had a big increase [in M-1B] in April. My forecast was that it might not look too good or that people might not want to say that we should go all the way to "C," which implies about 1 percent [M-1B growth for April to June] by the time we state it in the directive. Stated flatly, we're certainly around the "B to C" area; both the Committee and the non-Committee members, looked at individually or collectively, are split someplace between "B" and "C" with a little flavor of between "A" and "B." The question I would raise is whether we can reconcile that part of it, and I'll get to the borrowings and the other issues in a minute. If you look at the way the record has been stated historically, the most consistent way is that [at this point in the quarter] we'd put in a growth rate for April to June.

MR. WINN. Is it through June or to June, Paul? I'm worried about the lack of [unintelligible].

CHAIRMAN VOLCKER. Well, it means through June. We next meet at the beginning of July, don't we? I wondered, when I looked at it, whether we could even put in a growth rate through July. I thought about it after the Bluebook was prepared. But generally we go on the theory--maybe it's not a good theory--that we set something for the quarter and then review it at the middle-of-the-quarter meeting. We can get some of that flavor--I don't know whether this captures some of the [concerns] or not--with a slight rewriting. The draft directive says "In the short run the Committee seeks behavior of reserve aggregates consistent with a substantial deceleration of growth in M-1B from April to June"--and that's shift-adjusted--"to an annual rate of \_\_\_\_ percent". This language is all the same so far. Consistent with this approach, we presumably could put in something like the "B" number or we could put in [the "B" number and] "or lower, as may be consistent with the objective for M-1B adopted by the Committee on March 31" and then repeat that number. If we want to go that way, I think it says that we are between "B" and "C." And then we'd put some M2 number in there. We could go that way or we could just put in a lower number--we can't put in a much lower number--and say "or lower." To get absolute consistency with what we did last time, we would [have to] say "C" or lower. Last time the directive simply said "5-1/2 percent or somewhat less," so theoretically we could do that. I confess to my own bias of rather liking some feeling in the directive that we are not going to hit a precise number, because we are not going to anyway, and giving some flavor of which way we want the errors to go.

Well, let me just get a very preliminary reaction to something like that. Let me say specifically that we are putting in 3 percent but with the period April to June. In any case, we want a substantial deceleration--I'm just talking about M-1B--to an annual rate of 3 percent or lower, as may be consistent with the objective of 5-1/2 percent for the quarter that we adopted last time.

MR. GRAMLEY. What is the purpose of putting the rest of the language in there? If we say 3 percent or lower, what function does the rest of this language serve?

CHAIRMAN VOLCKER. It just ties it back to what we said before as to what [M-1B growth for] the quarter should be; it's an element of continuity and it's not really a lower limit. I don't think we can control M-1B that closely, so its purpose is to give some idea of what we mean by a little lower, I think.

MR. ROOS. Is there no reference to NOW accounts? That's because it's shift-adjusted. I get you.

CHAIRMAN VOLCKER. Yes, it's shift-adjusted. We are all talking about the shift-adjusted number--or I am--at this time.

MR. GRAMLEY. To get [a growth rate of] 5-1/2 percent or somewhat less for March to June, we are going to have less than 1.3 percent for April to June. That bothers me; it seems to me that we are putting in figures that are really not consistent with one another.

MR. BLACK. I think that's right.

CHAIRMAN VOLCKER. Well, I guess I disagree with that. But it's a question of approach. My [point] on this is that we are not going to hit a precise number anyway, so it's useful to give the direction in which we would like to go from whatever precise number is put in. Or we could be completely neutral. If if we put in something as high as 3 percent as the center of gravity of the Committee, I would interpret that as not neutral; we'd rather come in lower than higher. And that's what I'm--

MR. GRAMLEY. But that first "lower"--the phrase "an annual rate of 3 percent or lower"--connotes that. I wouldn't have judged that the Committee's view is that [M-1B growth of] 1 percent or less is what we are really shooting at. And 1.3 percent or less is what we'd have to get if we are going to get 5-1/2 percent or less from April to June.

CHAIRMAN VOLCKER. Well, this is the question. The question obviously was not asked this way, but let me ask the question. Suppose we have a happy day and those late May figures come in rather low and it looks as if, indeed, we may come in lower than 1 percent for May and June with interest rates not rising and maybe falling under those circumstances. Would the Committee consider that an unhappy result or a happy result? I myself would be rather happy. And, therefore, I would not want to be pushing out money if the growth rate happened to come in, let's say, at zero in May and June, if interest rates were already stable or declining.

MR. GRAMLEY. I don't have any objection to that, but what that postulates is that we hope to have another downward shift in the demand function for money. And if we do, that is fine and the money numbers will look better. Unless we get a very marked turnaround in the behavior of the economy in the near term, what that would imply is that the money demand function is not behaving as the staff has assumed. I don't know why we would want to wish for something like that. That really doesn't do any good; it just makes the numbers look better.

MR. PARTEE. There's some advantage to that.

CHAIRMAN VOLCKER. I'm not sure I follow your concern. I would argue that without some wording of this sort--not that the wording is all that critical--the Committee would begin getting worried that money growth was coming in too low and would want to raise it a little. And I'm not sure we want to do that.

MR. BOEHNE. Perhaps what Governor Gramley is getting at is this: Suppose we aren't so lucky and growth in May and June comes in, say, at 3 or 4 percent. Then how would that 3 or 4 percent be interpreted as being consistent with 5-1/2 percent or less?

CHAIRMAN VOLCKER. Well, it wouldn't be. But in that case it's not consistent with the 3 percent either.

MR. BOEHNE. Well, suppose it's just 3 percent?

MR. PARTEE. Maybe the problem is the [wording] "as may be consistent." Perhaps we should indicate the direction of the move not "as may be consistent" but "in order to be more consistent" or something like that.

CHAIRMAN VOLCKER. We can look at this language if you want.

MR. PARTEE. As I read this construction, Paul, I would have said that the Committee would strongly resist growth above 3 percent and that it would be more or less indifferent between, say, 3 percent and zero. That's the way I look at it.

CHAIRMAN VOLCKER. Yes, I think that is what it is meant to convey, if we put the number 3 percent in there. There is nothing to say we have to put 3 percent in there; we can put in a different number.

VICE CHAIRMAN SOLOMON. The way I read it, though, is that we would also be resistant to [M-1B growth] below 1-1/4 percent or whatever the number is, as long as it was consistent [with the target for the quarter].

CHAIRMAN VOLCKER. Yes, but then it says the previous target was 5-1/2 percent or less.

MR. PARTEE. And that's why I said that. Well, any positive number would be all right.

CHAIRMAN VOLCKER. I would read it the way you did and maybe even add one of the negative numbers.

MR. SCHULTZ. Suppose we said "3 percent or lower unless it becomes inconsistent." What happens if we do that?

MR. BLACK. But wouldn't 3 percent itself be inconsistent?

MR. PARTEE. That moves us toward consistency, but it doesn't really make it consistent. That's the point.

CHAIRMAN VOLCKER. Well, what's consistent? We are talking about a very small number for two months. That's the problem I always have with these things. One thing I'm sure of is that in one meeting out of about twelve we may be within 1 percent of one of these numbers. There shouldn't be a comma after "percent" anyway. It would be "\_\_\_ percent or lower."

MR. AXILROD. The comma after percent is meant to indicate that it's only the lower part that is consistent.

VICE CHAIRMAN SOLOMON. If we discuss the central issue first, maybe this clause will fall into line more easily. If we say 3 percent, we are going squarely for alternative B. It's only if luck comes along that we are going to accept lower [growth]. The consensus of the Committee was clearly for between "B" and "C." Some people had "C," some people had "B," and no more than one or two were between "A" and "B." I think 3 percent doesn't reflect the Committee consensus.

CHAIRMAN VOLCKER. How we set this up depends upon where the borrowings go. But I do not read this at all the way you are now reading it. It says 3 percent or lower and it refers to the consistency. I read it the way Mr. Partee reads it.

VICE CHAIRMAN SOLOMON. It means, though, that the setting of our reserve path would be based on 3 percent, wouldn't it?

MS. TEETERS. Is that what sets the reserve path? It's borrowing, isn't it, that sets our reserve path?

VICE CHAIRMAN SOLOMON. Well, initially.

MR. PARTEE. Yes. If we raise that initial level of borrowing by anything like what the staff has proposed, that absolutely swamps the difference in the reserve path between, say, 2 and 3 percent, doesn't it, Steve?

MR. AXILROD. Sure.

MR. PARTEE. You must be talking about a lot more money over the two months with a \$500 million adjustment of the initial borrowing than you are with the difference between 2 and 3 percent.

CHAIRMAN VOLCKER. Forget about the language at the moment. My interpretation of this language, as I say, is very much the way Governor Partee suggested. There's no point in saying that we are not going to permit something above 3 percent. We don't know. Maybe it will come in above 3 percent. We may set the borrowings at \$3 billion and it could come in above 3 percent. Forgetting about the language, is this where we want to be? Will we resist pretty darn hard growth above 3 percent but be quite relaxed below 3 percent down to zero or I

would say even below zero, depending upon how things develop in the market for this 2-month period? Is that what we are trying to say?

VICE CHAIRMAN SOLOMON. I would hope that we are trying to say that we'd [strongly] resist growth above, say, 2 percent or something like that, if we want to start somewhere between "B" and "C."

CHAIRMAN VOLCKER. I must confess that I don't know what the operational meaning of that is for M1-B [growth]. All I have are forecasts that are right within [a range of plus or minus] 10 percent.

VICE CHAIRMAN SOLOMON. I think there's a value in showing that we are determined and are trying to be very closely consistent with our previous short-run target. It just adds to our credibility. And, as various speakers have said, I would rather see the rate pressure now than later in the year. It's obviously not a matter of life and death when we are talking about [a difference of] something like 1 percent, since we don't control it that closely. In terms of what our target is, it seems to me better to be in a fairly tight position even if we are a little more relaxed on the initial [unintelligible] assumption.

MR. CORRIGAN. From my vantage point, if we had 3 percent in there as you suggest, Mr. Chairman, and in fact ended up there, that wouldn't bother me too much because I don't see an enormous difference even between the 6-1/2 percent [of "B"] and the 5-1/2 percent [of "C"] for March to June. My concern is this: I'm inclined to the view that whatever we set we are likely to exceed in this immediate situation; and given the lags in the reaction process both by us and by the banks, if we start out saying we would live with 3 percent, we could easily end up with a quarterly growth rate for March to June of not 6-1/2 percent but even more than that. I'm not sure what [directive] construction allows us to deal with that.

CHAIRMAN VOLCKER. Well, I don't think any construction allows us to deal with that. What allows us to deal with that is where we go on the borrowing assumption right now. I don't see people being all that gung ho on the borrowing assumption that the staff says is consistent. I'm not sure it is. The staff estimate may be too high. I think we ought to get some understanding of what we are talking about here, but the only difference it makes in the real world is what number the outsiders read six weeks from now or when it's all in the past anyway. We can obviously put in 2 percent here. That goes squarely in between.

MS. TEETERS. What kind of borrowing are we putting in?

CHAIRMAN VOLCKER. Well, we will get to that in a minute.

MR. FORD. Paul, in your statement a moment ago you asked us if what we are trying to say is that we don't care how far down [M-1B growth] goes. My reaction to that is that we shouldn't have it open-ended at the bottom. I think "somewhat less" is the right tone. I wouldn't want to see the aggregates collapse again as they did a year ago and be at the floor [of the long-term ranges] once again.

CHAIRMAN VOLCKER. We can write this more straightforwardly perhaps by just using a sentence that has a number in it and then go on to say that a shortfall in growth for the two months from the rate specified above would be acceptable. That's saying the same thing in two sentences.

MR. GRAMLEY. If we are going to say "or lower," that second sentence is already implied, it seems to me.

CHAIRMAN VOLCKER. Well, this is partly a question of whether we want to tie it back to the objective for the quarter that we set earlier. I don't know whether it's a good idea or not. But if we follow this idea that we set a target for the quarter and we shouldn't forget about it six weeks later, it's useful to make a reference.

MR. FORD. Stick to your guns.

MR. BALLES. I think it would be less confusing if we followed what Tony suggested by putting in 2 percent and dropping the words "or lower."

CHAIRMAN VOLCKER. I don't think we can do that here with the rest of this. We can't say 2 percent, which is higher than the previous target, and say it's consistent.

MR. PARTEE. We could make it a range. We haven't used a range.

CHAIRMAN VOLCKER. We can put in a range. I have thought of that, too.

VICE CHAIRMAN SOLOMON. Or we can say "2 percent or somewhat lower."

MR. CORRIGAN. What's wrong with a range? I guess the problem is that it doesn't let us deal with the bottom side.

CHAIRMAN VOLCKER. The only fear I have of ranges is that we can put in a range of 2 to 3 percent and we won't be within it anyway. And people attribute special importance to a range as a whole. That's my only objection to a range.

MR. CORRIGAN. For the sake of discussion: If we set a range of 1-1/2 to 3 percent so as to be generally consistent with the quarterly objective and--

CHAIRMAN VOLCKER. You're going to get all excited if it's less than 1-1/2 percent?

MR. CORRIGAN. I'm not. That's the problem.

MR. PARTEE. It really ought to be zero to 3 percent or something like that.

MR. AXILROD. Mr. Chairman, I don't know if it would be helpful, but part of the reason for wording such as this or the other wording you suggested is technical. I understand that if the Committee put a number in there of 2 or 3 percent, we would construct

the target on 2 or 3 percent or whatever the number is; and at whatever point the Committee felt they were willing to have a shortfall, as money was coming in short we simply would lower the nonborrowed targets commensurately, if that's what the Committee intends this kind of instruction to mean. Under that assumption we would really need to know pretty much in a general way what the lower limit is below which the Committee doesn't want the nonborrowed path lowered any more. That was why we felt it might be useful to tie it to the March-to-June target the Committee had already set.

CHAIRMAN VOLCKER. The effort is to get some sense of a range without saying we have a range that's only one or two percent [wide]. That [kind of range] sounds more rigid than I think we can afford to be.

MS. TEETERS. What Steve is implying is that the lower limit would be the 1.3 percent rate of growth.

MR. AXILROD. Or whatever by saying "somewhat less." It's literally what the Committee set for itself at the previous meeting. That's what this kind of wording would imply: That it's something like the lower limit.

CHAIRMAN VOLCKER. I am inclined to feel that we ought to get something in there [that gives some definition to the] "or lower." It's something of an experiment, but I think it may be useful experimenting to see whether we like referring back to the quarterly ranges in these interim meetings. We may get in trouble because sometimes we may not want to refer back to them. But if we don't, we don't. In this case I think it may be useful [to do so]. This other language may be better, saying whatever growth rate we want to use--perhaps an annual rate of 2 or 3 percent--and maybe putting in an "or lower" and whatever the consistent number is for M2. I don't know. [We could say]: "A shortfall of growth in M-1B from the 2-month rate specified above would be acceptable in light of the rapid growth in April and the objective adopted by the Committee on March 31 for growth from March to June at an annual rate of 5-1/2 percent or less." This other way tried to compress it into one sentence; maybe that isn't wise.

MR. FORD. Are you going to leave out the fed funds range?

CHAIRMAN VOLCKER. No, I'll get to that. Let's take it one thing at a time.

VICE CHAIRMAN SOLOMON. Speaking for myself, I feel that there is some value in referring back; I don't think it's enormous. Either formulation, as spelled out here or with a separate sentence talking about accepting a shortfall in the more straightforward way is okay. I think pretty much everybody would want to have X percent or lower at a minimum, and I think there's some slight advantage in referring back to that target for the period.

CHAIRMAN VOLCKER. Well, as nearly as I can see at the moment, I think we are only left with whether we take this or make it two sentences. The question is whether to put in 2 or 3 percent to start with. It doesn't bother me much either way.

MR. BLACK. Mr. Chairman, the way you have separated that and made it into two statements to my view and Lyle's--he and I were chatting--eliminates the problem he raised of the 3 percent not really being consistent. If you say the Committee would also accept a lower figure, which in a sense would be consistent with the 5-1/2 percent, I think you have eliminated the problem--assuming that you can get people to vote for the 3 percent.

MR. PARTEE. "3 percent or lower" is what it says?

CHAIRMAN VOLCKER. Actually, now the way it's written here it just says 3 percent and then the next sentence goes on to say a shortfall would be okay.

MR. PARTEE. I see.

MR. BLACK. Which would be consistent.

CHAIRMAN VOLCKER. Now, we could say "3 percent or lower" and say that a shortfall would be acceptable because of--

MR. BLACK. Yes, that's what I was thinking

CHAIRMAN VOLCKER. Well, I think we are close to this two-sentence version. The question at the moment is the borrowing. Not everybody mentioned it; a minority mentioned it. Of those who did the levels suggested ranged from \$2 billion to \$2-1/4 billion. The latter was the highest. We had some at \$2 billion and some at \$2 billion plus--\$2.1 to 2.2 billion. A lot of people didn't say anything. So, I think it's clear that we start out at least at \$2 billion, which is about \$150 million above where we are. The question is how much, if any, to go above the \$2 billion at the start, with the recognition--particularly if we start around \$2 or \$2.1 billion--that if [M-1B growth in] the latter half of May comes in high, we are going to raise that.

MR. SCHULTZ. Starting out with \$2 billion is starting out \$250 million above where we are.

CHAIRMAN VOLCKER. Well, I'm not quite clear where we are at the moment. I thought we were at least at \$1.8 billion.

MR. STERNLIGHT. The borrowing that we are aiming for--the borrowing consistent with this week's nonborrowed [path]--would be about \$1860 million. Borrowing for the 3-week subperiod would be about \$2 billion. But if you want to take where borrowings actually have been this week thus far, it's \$1.7 billion.

CHAIRMAN VOLCKER. We know where it has been this week so far. We only have two numbers. What we were aiming for this week at this moment on our present track is \$1860 million, I take it. And we have been averaging \$2 billion, so \$2 billion really isn't all that much of a change. It's a little higher than where we are aiming right at the moment, but not higher than where we have been. I don't think \$2 billion implies all that much of a change, so we may want to make it just a shade higher than that. But a lot of people haven't been heard from. Whom do we have for something between \$2.1 and \$ 2.2

billion--\$2.15 billion, I suppose, just to split that--which is about \$300 million higher than this week's figure.

MR. SCHULTZ. Doesn't that have something to do with the fact that there aren't any excess reserves out there?

VICE CHAIRMAN SOLOMON. It's swinging up and down.

MR. AXILROD. Well, we tend to adjust to that, so if [the demands for] excess reserves turn out high, we tend to supply them.

MR. SCHULTZ. But the point is that if we move borrowing up, we ought to get a fairly quick effect, shouldn't we?

MR. AXILROD. Well, I think \$2150 million probably would be consistent with a higher federal funds rate than we have experienced thus far, [which is] in the 18-1/2 percent range.

MR. GRAMLEY. What would you guess that would be?

MR. AXILROD. I would say between 19 and 20 percent, give or take some.

MR. PARTEE. Which is right at the very top of the range that we have specified here.

MR. SCHULTZ. It sounds strong to me. That's why I started out with \$2 billion. But I certainly would be interested in moving it quickly, depending upon what kind of reactions we see.

CHAIRMAN VOLCKER. Well, let me just try \$2.1 billion and see whether there's a consensus for that.

VICE CHAIRMAN SOLOMON. We're down to voting members?

CHAIRMAN VOLCKER. Well, I'm asking for a vague consensus now. How many are happy with \$2.1 billion?

MR. PARTEE. Would accept or would make one happy?

CHAIRMAN VOLCKER. Well, I wasn't getting that precise. I was trying to get to some kind of consensus. I take it there's no overwhelming happiness at \$2.1 billion. I don't know which direction to go from the \$2.1 billion.

MR. PARTEE. I could accept it. But try \$2 billion.

CHAIRMAN VOLCKER. I'll try it. Does \$2 billion make people unhappy? I have a lot of no hands raised here. Does \$2.2 billion make people happier?

SPEAKER(?). How about \$2.1 billion?

MR. PARTEE. I think you hit the right number, but it's whether it's preferred or acceptable.

SPEAKER(?). \$2.1 billion is acceptable.

CHAIRMAN VOLCKER. Is \$2.1 billion acceptable? We'll remain very tentatively there at the moment. Let's [discuss] the federal funds range. First of all, the question has been raised whether we should have it at all, I guess. Did you hand out these other--

SPEAKER(?). Yes.

CHAIRMAN VOLCKER. I have a series of reworded sentences. I have one reworded sentence that assumes we keep it; let me see what the change is from what we now have. Maybe Mr. Axilrod can explain it to me.

MR. AXILROD. The essential sentence that you have there says that if it appears during the period before the next meeting that fluctuations in the funds rate, taken over a period of time, within a range of \_\_ to \_\_ percent are likely to be inconsistent, etc., the Manager will inform the Chairman, who will then decide whether the situation calls for supplementary instructions. That sounds as if the federal funds rate is an objective within the [context] of the instructions. The proposal, in line with some of the [points] raised by Committee members, essentially has the same beginning but it tries to make the federal funds rate seem more like a consultation point that involves a little more flexibility. It says that if it appears during the period before the next meeting that pursuit of the monetary objectives and related reserve paths is likely to be associated with a funds rate range persistently outside a range of \_\_ to \_\_ percent, then the Manager will inform the Chairman--the same sort of instructions as before--but then it says "who will then decide whether consultation with the Committee is necessary."

MR. SCHULTZ. When I was looking at this before, the one thing I didn't like about it was the use of the word "necessary." Is that a good word or is "advisable" a better word there? If we say it's necessary, are we not then implying that again the fed funds range is part of the--

MR. PARTEE. That's a good point. This construction with "advisable" would be better.

MR. AXILROD. Well, it reads to me literally as saying that the Chairman could permit the funds rate to go almost anywhere.

VICE CHAIRMAN SOLOMON. Well, I think that's a mistake anyway. If we are all saying that the purpose of the funds range is to trigger a consultation, then we should not imply so clearly that the Chairman can veto a consultation and in effect abolish the FOMC and run a one-man FOMC.

MR. ROOS. Why wouldn't the same wording apply to the borrowing assumption and to the aggregates? In other words, isn't this an implicit prerogative of the Chairman on any of this? He can call us any time as long as he doesn't call collect!

CHAIRMAN VOLCKER. Well, I think we ought to discuss whether we want this at all, which I guess is the question you're raising. I'm obviously at the hands of the Committee, but I don't find any difficulties myself, and I see some advantages, in saying if interest rates move extremely enough the Committee at least wants to review

what the heck it's doing. I think that's the question. If we really think that, then I'm inclined to feel that we ought to say it. If we don't think that and genuinely don't think this is anything to be worried about, then we [could] leave it out. Now, we could write this to say that if either the money supply is moving well outside its range or if the federal funds rate is moving well outside its range, we would consult. And I think that is true in a sense. The difference in the implication is that if the money supply is running outside its range, we know what to do if it doesn't involve conflicts with these other things. We know what to do in the sense of the general direction.

MR. SCHULTZ. I think if the money supply is running outside its range, you will consult [with the Committee]; and if the fed funds rate is running well outside its range, then you may consult.

CHAIRMAN VOLCKER. Well, I'm not so sure we would consult if it were running outside the range; it depends upon how far. It's likely to run outside the range in the short run, so we would make all these adjustments in borrowings and stuff that we talk about.

MR. SCHULTZ. All right.

CHAIRMAN VOLCKER. Now, if it went far enough.... What I think disturbs people is that we would want to look at [our decision] again if it implied a very large change in financial conditions that was not necessarily contemplated at the time of the meeting.

MR. CORRIGAN. If we use some language like this, is it absolutely essential that the language be right in the directive itself? Let me explain where I'm coming from. The advantage to a federal funds rate consultation guideline is that the federal funds rate, whatever else it is, is the only thing we have in the short run that is fairly unambiguous. Borrowings and the money supply and reserves and those things are all over the lot. The funds rate at least is unambiguous. I certainly agree with the idea of trying to get the markets and everybody else to recognize the de facto role that it plays. But I'd like to see something [about the federal funds rate] preserved, and I wonder whether it can't just be part of the general discussion and not right in the directive language itself.

CHAIRMAN VOLCKER. It could. It can be anything we want. At the present time, I am somewhat allergic to making that big a change in the directive because it will then give more significance to it than I think it's worth.

MR. WALLICH. Couldn't we perhaps say specifically that the Manager's operations are not to be constrained by the funds rate but that if the funds rate moves outside etc., the Committee will consult? Then it is clear that it is not a constraint.

CHAIRMAN VOLCKER. Well, I think we can say that. But the explanation you gave I'd be perfectly happy to put in the general discussion as background for this.

MR. BLACK. I like this, Mr. Chairman. It's a logical step in the process of moving where I think we eventually ought to be, if we can get the aggregates under control, of not having any limits. It

fits in with the step where we define the limits as a consultation point and it allows the Desk to move a bit before we have that consultation rather than delaying it maybe for a couple of days.

CHAIRMAN VOLCKER. Oh, it's for more than a couple of days, I think, under the current directive; we've done that historically.

MR. BLACK. I mean that if you decided to have a consultation, you might notify us a day or so ahead, and meanwhile the Desk might go ahead and go outside [the funds range].

CHAIRMAN VOLCKER. Well, I think they've been doing that anyway, but I agree with you.

MR. BLACK. But this makes it clearer to the market.

CHAIRMAN VOLCKER. Right. I think this comes pretty close. We can quibble about the language, but the intent of this is to be consistent with what we've been saying.

MR. BLACK. I think that's right.

MR. SCHULTZ. I rather like the other alternative we were talking about, which is that a Committee consultation may be called for by the Chairman if it appears during the period before the next meeting that the federal funds rate is likely to be significantly outside a range of \_\_\_ to \_\_\_ percent for an extended period.

SPEAKER(?). I think that's pretty much the same.

MR. SCHULTZ. I thought that was pretty straightforward.

CHAIRMAN VOLCKER. Well, I'll tell you. What I don't like about that--and we're talking about nuances--is that it has no connotation that we're following a reserve path. That sentence in and of itself can be interpreted to mean that we really set this federal funds range as a range.

MR. PARTEE. Also, it seems to me that there ought to be a professional judgment on the part of the Manager that it's going to run well outside the range rather than that the Chairman is making this decision. If we want it to be a technical question, it seems to me it ought to be a Manager's question.

MR. ROOS. If any mention of this were totally omitted, where could the problem conceivably arise in the markets? If we just stop referring in any way to a federal funds--

CHAIRMAN VOLCKER. Well, there are two questions. Forgetting about the market, there is just the question of what the Committee wants to say and whether it wants to have a consultation. If we do, then I think we ought to put it down. But so far as the markets are concerned, I think that it will be read as--

SPEAKER(?). As an underlying focus.

CHAIRMAN VOLCKER. --a further step in the direction toward ignoring this, and they would expect more instability rather than less

in some sense. They'd feel we had changed in some more fundamental way than this discussion seems to imply.

MS. TEETERS. Mr. Chairman, I like the way it was in the original here.

CHAIRMAN VOLCKER. Do you mean the way it was last time?

MS. TEETERS. Yes.

CHAIRMAN VOLCKER. The way it has been?

MS. TEETERS. The way it has been, where the situation calls for supplementary instructions from the Committee. I think that's what it is we want. I'd rather not have all that stuff about necessary and persistent and the rest; I'd just leave it alone.

CHAIRMAN VOLCKER. I can live with it the way it is. This is an effort to say what we've said more informally.

MS. TEETERS. I think we can just say it informally and leave it that way. It has caused a useful consultation for everybody; it has marked a point at which we make a decision as to whether we're going to do it or not do it.

MR. SCHULTZ. But, unfortunately, the way we have said it has led to the feeling on the part of a lot of people in the markets that we still do have a fed funds rate target.

MS. TEETERS. But, Fred, we've violated the range practically every time, with only one exception.

MR. SCHULTZ. I understand what we've done. It's just that I think there still is a misperception in the market, which it seems to me we might be able to clear up with some rewording. I do have some reluctance about changing it, just on the basis on the fact that every time we make a change there is some confusion in the market. So, whether it's worth making the change is a question. My feeling is that it would be good if we did change it. I would hate to see us give up some kind of fed funds range because I think the uncertainties that we're dealing with here and the relationships between the aggregates and the economy are so difficult that the fed funds rate tells us something. There can clearly be a situation in which something is happening out there and we ought to be consulting. But that's what we're doing. We keep telling people that that's what we're doing and they don't believe us very well because this range appears in the directive.

CHAIRMAN VOLCKER. Mr. Altmann reminds me, and I will remind you, that in what we're going to publish Friday or whenever we publish it, we have a paragraph in the general discussion that says: "With respect to the federal funds rate,"--it probably should say the federal funds rate range--"it was stressed that the Committee specified an intermeeting range for fluctuations over a period of time to provide a mechanism for initiating timely consultation between regularly scheduled meetings whenever it appeared that fluctuations within the specified range were proving to be inconsistent with the objectives for the behavior of reserve and monetary aggregates. Thus,

the limits of the range were indicative of the conditions under which the Committee would wish to consult to reexamine its short-run objectives and were not intended as binding constraints on System operations pending such consultations."

MR. GUFFEY. When will that be published? Is that in the directive?

MR. ALTMANN. That's in the policy record for the March meeting, which will come out this Friday.

CHAIRMAN VOLCKER. I take it that there is a general feeling that we should continue to specify something. Is that correct?

SPEAKER(?). Yes.

CHAIRMAN VOLCKER. That's a majority. One can make an argument that in the light of all we have said the present language is increasingly well understood and that we always run some danger of a renewed misinterpretation by changing it at all. So, we can just leave it as it was. That's one option. The other option, if I'm reading it right, is something very close to what was distributed here, which is not a very drastic change anyway. Which of those two options commands the greatest support? Let me try the option of not changing the language at all. Who is for that? Do I conclude from that that there is positive support for at least a modest change in the language by the other 15 people sitting here? If that is right, then we are down to the particular wording. You have one version in front of you.

MR. GRAMLEY. I have a suggestion, which incorporates Governor Schultz's thoughts and I think gets around the points that both you and Governor Partee raised. It reads as follows: "The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with the federal funds rate persistently outside a range of \_\_\_ to \_\_\_ percent."

VICE CHAIRMAN SOLOMON. But if you say "persistently" then don't you have to say that the Chairman will call for a consultation?

MR. GRAMLEY. Well, I don't think we ought to deny the Chairman the opportunity to make a decision on his own.

CHAIRMAN VOLCKER. I think you can be sure that the Chairman will [do so], whatever the language says. So this is just a nicety of whatever language it is.

VICE CHAIRMAN SOLOMON. Oh yes, I know that. I'm not talking about substance; I'm talking about images.

MR. PARTEE. It says "may," but it certainly implies that he's going to do it.

MR. SCHULTZ. I prefer "may" because "will" implies that there is a target there.

MR. PARTEE. I think that version is considerably better than this one.

CHAIRMAN VOLCKER. Well, in substance, it seems to me to say the same thing.

MR. PARTEE. Yes.

MR. GRAMLEY. Exactly the same, but it leaves in the reserve path and the monetary aggregates, it lets the Manager for Domestic Operations make the technical decision, and it says the Chairman "may" call a consultation.

CHAIRMAN VOLCKER. Read it again.

MR. GRAMLEY. "The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of \_\_ to \_\_ percent."

MR. PARTEE. That certainly puts the reserve issues first; there's no question about it.

MR. GRAMLEY. And I think it's a clear statement of what we're trying to accomplish and what is available presently.

CHAIRMAN VOLCKER. Very honestly, I don't detect a substantive difference, but it's perfectly all right with me.

MR. BLACK. I don't think there's a difference, but I think it's worded a little better.

MR. GRAMLEY. It's just a matter of wording, really.

MR. GUFFEY(?). Mr. Chairman, for the moment, I'd like to try to make a case to keep the language as it is presently. The markets and the public have not seen the March change in the language, which I think is rather specific and good.

CHAIRMAN VOLCKER. It's not a change in the directive language; it's an explanation.

MR. GUFFEY. Yes, it's an explanation. But if we then come along a month from now and publish a directive, which may mean the same thing to us but changes maybe 60 words, that will give rise to the analysts publishing from now until at least the end of the year all sorts of interpretations. I think that's what we don't want. It seems to me that consistency would best be served by leaving the language as it has been published in the directive, with an informal understanding in the Committee with the Chairman that it is a consultation point as described in the record.

CHAIRMAN VOLCKER. Well, I think the argument for not changing it at all is that it may be more confusing to change it. We'll see whether your comments changed to more than 4 votes the number who want not to change it.

MR. PARTEE. I must say that I think that's incorrect, Roger. I wasn't at that telephone conference call and I read with some amusement the paragraph that was just [quoted]. I think it is stretching things to say that the earlier instruction could be interpreted in the way it was interpreted in that meeting. And I think what is now being proposed is consistent with the interpretation in the telephone conference call. It was a stretched interpretation, which now needs a different instruction, I think, if we're going to stay with it and use it. So, I do believe a change is necessary.

CHAIRMAN VOLCKER. Have you convinced anybody, Roger? Do you have more than 4 votes for not changing it?

MR. GUFFEY. I'm more convinced myself, but it--

VICE CHAIRMAN SOLOMON. I think Roger has a point that there is a danger. We will, of course, publish the policy record from the earlier meeting and it has this language, which I think exactly summarizes our feeling about it. Then if we come out with another directive, there is a danger that some of the Fed watchers may believe that we mean to change the significance of this paragraph on page 9 [in the March] policy record.

CHAIRMAN VOLCKER. Any change we make may be confusing. I don't disagree with that.

VICE CHAIRMAN SOLOMON. Right. And since the policy record paragraph on page 9 expresses exactly what we're trying to do, then it seems to me, even though I guess this may be too unorthodox, that we could simply refer here to that policy record paragraph.

MR. PARTEE. Always? At every meeting refer to that policy record interpretation?

CHAIRMAN VOLCKER. Look, we can attempt to handle that problem. I think there is some danger, which we can't get around, that with any change in wording somebody will look at it and say: Do they really mean what they say? We can put in the policy record what we mean: That what we really have done is to change this language slightly to make sure it conforms with what we said last time.

SPEAKER(?). Sure.

MR. GUFFEY. But we'd be taking a risk if we do that.

MR. PARTEE. That's the way to do it.

VICE CHAIRMAN SOLOMON. But couldn't we simply say, taking Lyle's language, for example, "as called for in the policy record of such and such a date" so it makes quite clear that this is simply a summary version of the larger explanation in the policy record?

MR. GRAMLEY. But this is supposed to be the operating paragraph of the directive.

CHAIRMAN VOLCKER. It's only a formal point as to whether it's desirable or not to be in the directive.

MR. PARTEE. Well, you don't mean to put it in the directive. You mean to have in the policy record entry for today's meeting a reference to the previous policy record saying that the Committee adopted this language in furtherance of its determination in the earlier meeting.

VICE CHAIRMAN SOLOMON. No, I had meant--

MR. PARTEE. Oh, I see.

VICE CHAIRMAN SOLOMON. I raised the question of whether it would be appropriate to have a reference in this one-sentence summary to this larger explanation in the policy record as consistent--

MR. SCHULTZ. I don't like that much, but I think what Chuck is suggesting is fine.

MR. PARTEE. We could reference it again in the record for today's meeting.

MR. ALTMANN. An interpretation of the funds rate range?

MR. PARTEE. Yes.

MR. ALTMANN. You mean reiterate it in this--

MR. PARTEE. Then that becomes an explanation for why we changed this wording, so that people don't think there's something more that we did, because after all it will come out [later]. They will know about this wording and then they'll have the explanation of the wording at the very same time.

MS. TEETERS. But that explanation goes to what's here now.

CHAIRMAN VOLCKER. Unless people are ready to change their minds, I think there are these problems. I'll just return to my question: Has Roger convinced anybody that there is greater danger in changing the words at all?

SPEAKER(?). No.

CHAIRMAN VOLCKER. There's always a danger of some confusion here. There may be a little but I think we can handle it without undue risks. I could certainly live with it the other way. It's no big deal to me. If the issue had never come up in the first place, I wouldn't change it. But I--

MR. SCHULTZ. This is not my day!

VICE CHAIRMAN SOLOMON. Well, Roger has my vote.

MR. PARTEE. But he had it before, didn't he?

VICE CHAIRMAN SOLOMON. No.

CHAIRMAN VOLCKER. He didn't? Let's try it again: How many people would vote for no change [in the directive wording]? We're up to five; we have one more. That still is a minority.

MR. WALLICH. On [some] grounds I'd vote that way, though not because I like what we have now. But I don't like the change to which we're going, and I suspect we're not going to change it again soon, so we're losing an opportunity to improve it permanently.

MR. SCHULTZ. What would you do? Would you go further than what we're suggesting?

MR. WALLICH. I would stress the deviation from the aggregates and then come in from the funds rate.

MESSRS. PARTEE and SCHULTZ. But that's what Lyle's version did.

MR. WALLICH. No, I don't think he mentions the deviations from the paths.

MR. SCHULTZ. Yes, he did.

MR. PARTEE. Yes, those are the first words.

MR. SCHULTZ. That's exactly what he did.

CHAIRMAN VOLCKER. Do we have a consensus on Mr. Gramley's reworded version which, if I can read it, says: "The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations..." I don't know what happens if it appears to the Chairman, but not to the Manager.

SPEAKER(?). Then you better talk to the Manager!

MR. SCHULTZ. I have a feeling the Chairman can talk the Manager into--

CHAIRMAN VOLCKER. "...that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of \_\_\_\_ to \_\_\_\_ percent." Do I have a consensus on that? I hope I have more than 5 votes anyway. All right, let's assume that. Now we have to put figures there, it so happens.

MR. PARTEE. 5 to 50 percent!

VICE CHAIRMAN SOLOMON. You still don't have a consensus on 3 percent.

MR. PARTEE. We don't want to have--

CHAIRMAN VOLCKER. We will come back [to that]. Actually, very few people specifically commented on [the funds rate range]. Among the people who specifically commented, we have one mentioning a ceiling of 20 percent and three a ceiling of 22 percent. My notes only have that many comments.

MR. PARTEE. I said I would accept 16 to 22--

MR. SCHULTZ. With a "B" specification.

CHAIRMAN VOLCKER. Right. Well, I think it's probably a choice between 16 to 21 percent and 16 to 22 percent. I think there is an implication--these people may be wrong--that the upper end of this range is much more likely to be binding than the lower end during this period. And the range isn't absolutely symmetrical [around the current level]. I'm not sure it's so far from the [expected rate], depending upon what reserve number we put in there. But I would also presume that there is a bias; people recognize that it may be a bit asymmetrical, but they want to consult if it gets above whatever number we now put in, which seems to me to lie between 21 and 22 percent. How many 22s do we have?

MR. CORRIGAN. This is strictly as a consultation point, you're saying?

CHAIRMAN VOLCKER. Yes, that's right. It looks as if that's the prevailing view. How many would prefer 21 percent? It looks like we put the upper limit at 22 percent; 16 to 22 percent, I guess.

MR. GRAMLEY. Have we ever had a 6-point range before?

SPEAKER(?). Yes.

SPEAKER(?). Yes, we have.

MR. PARTEE. Yes, we've backed away from--

CHAIRMAN VOLCKER. All right. Now we have this reworded sentence and we have that range tentatively settled at 16 to 22 percent. Let's come back to the borrowing. Is \$2.1 billion the consensus?

SPEAKER(?). Ask for a vote.

CHAIRMAN VOLCKER. How many people are willing to put in \$2.1 billion immediately? That looks pretty good at a quick look. Now we come back to the [wording of the] paragraph. What I am suggesting is: "In the short run the Committee seeks behavior of reserve aggregates consistent with a substantial deceleration of growth in M-1B from April to June to an annual rate of \_\_ percent..." The question is whether we put in "or lower" there. The sentence continues with a comma and then: "after allowance for the impact of flows into NOW accounts, and with growth in M2 at an annual rate of about \_\_ percent. A shortfall in growth of M-1B from the two-month rate specified above would be acceptable, in light of the rapid growth in April and the objective adopted by the Committee on March 31 for growth from March to June at an annual rate of 5-1/2 percent or somewhat less." Is that general language okay? I think that's where we arrived before. We have to fill in the blanks and decide whether to put in "or lower". As nearly as I can see, it's a simple choice between 2 or 3 percent. How many 3 percenters do we have?

SPEAKER(?). If it's "or lower."

CHAIRMAN VOLCKER. Okay. Let me assume it's 3 percent or lower, if we take the 3 percent.

SPEAKER(?). Okay, I'll go with that rate.

MR. ALTMANN. Five voting members.

SPEAKER(?). Well, what's the alternative--"somewhat lower"?

CHAIRMAN VOLCKER. The alternative, I think, would be 2 percent without the "or lower," but the "lower" appears in the next sentence.

MR. FORD. We're going to say "lower" not "somewhat lower"? How far are you going with this?

CHAIRMAN VOLCKER. What the next sentence says is that a shortfall in growth would be acceptable. It refers back to the earlier [decision on the quarterly growth rate]. The choice is between "3 percent or lower" in the first sentence, which we just had an indication of views on, or 2 percent in which case I think we leave out the "or lower" but the [concept of] lower appears in the next sentence in the form of a shortfall.

MR. PARTEE. Do you want hands?

CHAIRMAN VOLCKER. Yes, for the 2 percent without the "or lower."

SPEAKER(?). Just voting members?

CHAIRMAN VOLCKER. Well, I don't know whether we're getting close here. Let me just take the voting members and go over it again. How many--just the voting members now--prefer the 3 percent or lower?

MR. ALTMANN. Five.

CHAIRMAN VOLCKER. Five, okay.

MR. BLACK. There's an exception.

CHAIRMAN VOLCKER. Was your hand up or down?

MR. CORRIGAN. I accept this.

SPEAKER(?). Do you prefer it?

CHAIRMAN VOLCKER. I asked for preferences at this point. Now, let me just make sure. Who prefers the 2 percent period? Six.

MR. ALTMANN. Six.

CHAIRMAN VOLCKER. That's great. Six and five.

SPEAKER(?). . [Not] including you.

CHAIRMAN VOLCKER. We're down to splitting hairs.

MR. PARTEE. How about 2-1/2 percent?

MR. SCHULTZ. How about "2-1/2 percent or somewhat lower"?

MR. FORD. Or "slightly."

MR. RICE. Why don't we find out what people can accept.

CHAIRMAN VOLCKER. Well, let me try. Who would accept the 3 percent or lower? Ten.

MR. PARTEE. All but Tony.

CHAIRMAN VOLCKER. We're within very narrow grounds. I'm interested in maximizing the happiness at this point. I biased this thing now. A lot of people will find the 2 percent unacceptable now, I presume. How many will accept the 2 percent?

MR. SCHULTZ. Accept 2 percent? I'll accept either one.

CHAIRMAN VOLCKER. Eight. I'm afraid I succeeded in biasing the thing.

SPEAKER(?). No, I was going to vote--

MR. SCHULTZ. I just really can't get awfully excited over this thing.

CHAIRMAN VOLCKER. It looks like 3 percent or lower. And maybe we should just start the second sentence by saying "The shortfall...", which refers back to the "lower."

MR. PARTEE. Yes.

MR. SCHULTZ. This is becoming a theology session!

CHAIRMAN VOLCKER. All right, now we have 3 percent or lower with this two sentence approach. We have 16 to 22 percent and we have borrowing at \$2.1 billion [without] an allergy toward raising the borrowing if [money growth] comes in high.

SPEAKER(?). M2?

CHAIRMAN VOLCKER. Oh, M2. Where are we on M2?

MS. TEETERS. 6-1/2 percent.

SPEAKER(?). M2 is 6-1/2 percent.

CHAIRMAN VOLCKER. All right. For conforming purposes, we've put in 6-1/2 percent. Because we said "or lower," we can put in 6 percent; that's [about] halfway between "B" and "C" and it's a nice round number.

MR. BLACK. 6-1/2 percent is [unintelligible].

CHAIRMAN VOLCKER. Okay, put 6 percent in there.

MR. PARTEE. Six percent looks about right, doesn't it?

CHAIRMAN VOLCKER. It just squares the thing. Okay, so we've got 3 percent or lower, 6 percent, 16 to 22 percent, and \$2.1 billion.

MR. SCHULTZ. And we'll be lucky to hit any of them!

CHAIRMAN VOLCKER. Yes. Is it clear what we're voting on?

MR. WALLICH. No.

MR. GRAMLEY. Mr. Chairman, may I call your attention to the second line of the general paragraphs, which I think is not entirely consistent with the views of the Committee on what is happening in the economy. It says: "...suggested that real GNP will probably grow little in the current quarter." That sounds like an awfully flat economy.

CHAIRMAN VOLCKER. Right.

MR. GRAMLEY. This is a fairly optimistic group. I would say: "suggested that GNP will grow more slowly in the current quarter."

MR. SCHULTZ. Yes, or not [unintelligible]. That gives us more room--

CHAIRMAN VOLCKER. Where does this all appear?

MR. GRAMLEY. It's in the second line of the general paragraphs.

CHAIRMAN VOLCKER. I think it's perfectly safe to say that it will grow more slowly.

MR. PARTEE. Than 8-1/2 percent or something like that.

MR. GRAMLEY. Or even, if you like, "will grow slowly." "Grow little" sounds as if the economy--

CHAIRMAN VOLCKER. No, I agree. "Grow more slowly" is perfectly all right. We'll make that change. Okay, you all know what you're voting on. Mr. Secretary.

MR. ALTMANN.

|                       |     |
|-----------------------|-----|
| Chairman Volcker      | Yes |
| Vice Chairman Solomon | Yes |
| President Boehne      | Yes |
| President Boykin      | Yes |
| President Corrigan    | Yes |
| Governor Gramley      | Yes |
| Governor Partee       | Yes |
| Governor Rice         | Yes |
| Governor Schultz      | Yes |
| Governor Teeters      | Yes |
| Governor Wallich      | Yes |
| President Winn        | Yes |

MR. SCHULTZ. My word!

MR. PARTEE. I think that's the first unanimous vote--

CHAIRMAN VOLCKER. We can go grab a sandwich.

MR. SCHULTZ. That's pretty good.

CHAIRMAN VOLCKER. Thank you. Wait a minute, do we have anything else?

MR. ALTMANN. Only the date of the next meeting.

CHAIRMAN VOLCKER. We have to confirm the date of the next meeting. Let me just say that I assume we can confirm that. But it's a meeting where we have to review the annual targets, so I think it's quite likely we might want to come in here the afternoon before.

SPEAKER(?). What's the date?

MS. TEETERS. July 7th.

SPEAKER(?). The 7th is Tuesday, but we may start Monday.

END OF MEETING